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THE RELATIONSHIP BETWEEN THE PROCESSES OF OUTSOURCING OF ITALIAN TEXTILE AND CLOTHING FIRMS AND THE EMERGENCE OF INDUSTRIAL DISTRICTS IN EASTERN EUROPE

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A dissertation submitted to the faculty of the University of North Carolina at Chapel Hill in partial fulfillment of the requirements for the degree of Doctor of Philosophy in the Department of Geography.

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ABSTRACT

CHRISTIAN SELLAR: The Relationship between the Processes of Outsourcing of Italian Textile and Clothing Firms and the Emergence of Industrial Districts in Eastern Europe. (Under the direction of Dr. John Pickles)

From an economic standpoint, the enlargement of the European Union means much more than commercial and political integration. It also means a merger and re-working of pre-existing production networks and structures that date back to the 1970s and 1980s. This dissertation research focuses on a more recent case of such expansion of networks and structures: the outsourcing of clothing and textile industries from industrial districts in Italy to Eastern Europe. It shows that the Italian economic involvement in Eastern Europe progressed from a 'light' form of involvement, such as subcontracting agreements between independent producers, towards 'deeper' forms of involvement, such as joint ventures and foreign direct investments. Bringing examples from four case study areas in Eastern Europe and the Former Soviet Union, this dissertation argues that the institutional change brought by the enlargement of the European is the key factor to understand the intensification of the Italian economic involvement in the region. Comparing the work of Italian textile and clothing firms in areas that joined the EU in 2004 (Slovakia), 2007 (Romania and Bulgaria) and non candidates for EU membership (Ukraine) this research shows the ways in which institutional change influenced the patterns and strategies of Italian investments in the region.

To my mother and my brother. To all the people who want to make the difference.

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This dissertation required an exceptional effort in order to work in five different countries and with several groups of people. The support of the following institutions, firms and individuals made it possible:

Informest, public agency supporting Italian companies in their investments in Eastern Europe through the provision of real non financial services, scouting and dissemination of information about the opportunities in the area;

IC & Partners Group, consortium of professionals and advisors specialized in assisting business that want to develop internationalization projects in the Countries of Central and Eastern Europe;

Foundation for Entrepreneurship Development, NGO specialized in small business, local economic development and public administration development research, consultancy and training, monitoring and evaluation;

CPL’ 92, consultancy in the field of business management, internationalization, marketing planning, information technology in both the public and private sector;

Business Support Center for Small and Medium Sized Enterprises – Rousse;

Bulgarian Academy of Sciences;

Economics University in Bratislava;

Christian University ‘Dimitrie Cantemir’ in Sibiu;

‘West’ University in Timisoara;

University of Bucharest;

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The Relationship between the Processes of Outsourcing of Italian Textile and Clothing Firms and the Emergence of Industrial Districts in Eastern Europe: Introduction

In Europe, a gigantic project of integration is underway. Led by the expansion of the European Union (EU) eastward into the former state socialist countries of Central and Eastern Europe, this is an experiment of institutional engineering, driven by a vision of institutions, societies and economies overflowing or at least crossing the boundaries of nation states. From an economic standpoint, EU enlargement means much more than commercial and political integration. It also means a merger and re-working of pre-existing production networks and structures that date back to the 1970s and 1980s. This research focuses on a more recent case of such expansion of networks and structures: the outsourcing of clothing and textile industries from industrial districts in Italy to Eastern Europe, where Italian textile and clothing firms are explicitly attempting to develop industrial districts in and around their new investments.

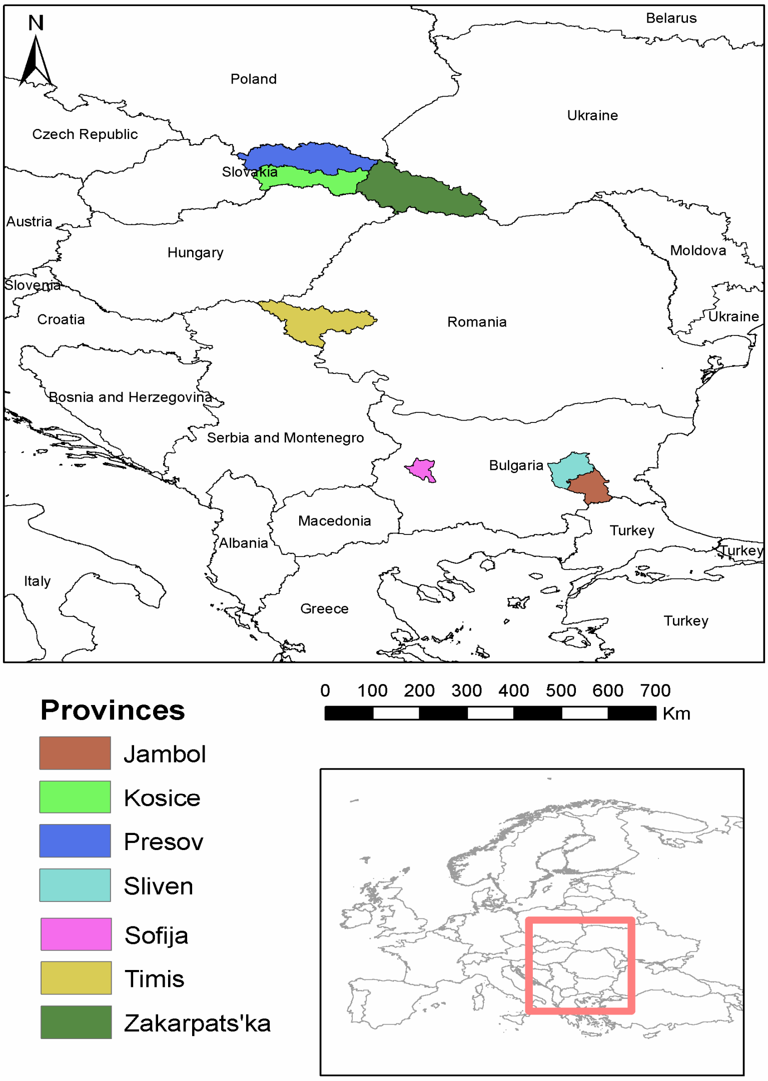
The aim of this work is twofold. First, it investigates the patterns of Italian foreign investments, using examples from textile and clothing industries, and assesses their impacts on institutional arrangements, business networks and practices in selected Eastern European host areas. Second, it assesses the extent to which these practices of networking are transforming forms of industrial governance, local economies, and economic competitiveness within the broader economy. The research focuses on comparative analyses of these attempts by lead-firms to stimulate industrial networks centered on new production facilities. To achieve its aim, the project asks three central questions. 1) What are the geographies of

Italian entrepreneurship in Eastern Europe? 2) How does the ‘Italian model’ influence industrial policies in Eastern Europe? 3) What kind of new networks are emerging as consequence of the Italian investments?

The dissertation research had been articulated between approximately nine months of fieldwork in Eastern Europe and Italy and eight months for the write-up. The fieldwork consisted in data collection, archival research, interviewing. This fieldwork is being funded by a *Doctoral Dissertation Improvement Grant* from the National Science Foundation, an *Off Campus Dissertation Research Fellowship* from the Graduate School of the University of North Carolina at Chapel Hill and the *Doctoral Research Travel Award* from the University Center for International Studies of the UNC Chapel Hill. The write up phase has been financed by a *Dissertation Completion Fellowship* from the Graduate School of the UNC Chapel Hill.

The areas where I conduct research are selected according to the following criteria: (a) the presence of a significant cluster of textile (and/or apparel) small and medium enterprises; (b) the increasing presence of Italian firms, or their subcontractors in the sector in the selected areas; (c) the existence of national, regional, or international initiatives to study or foster the emerging networks and interactions; and (d) sites in which the support of local scholars and/or representatives of the business community is available. Four areas have been selected for the dissertation research: Sofia, and the other location of the investment of the Italian textile group Miroglio (Bulgaria), Timisoara (Romania), Kosice/Presov regions (Slovakia) and L’viv/Zakarpattya regions (Ukraine). I spent around six weeks in each of these regions interviewing managers in Italian owned companies and their subcontractors, as well as local government officials involved in the promotion of foreign direct investments and the development of the local economy.

MAP 1: Fieldwork areas



This work contributes to the literature on regional economies by developing a model of the internationalization of Italian industrial districts and their impact on the post socialist transformation of Eastern Europe. In some areas of Eastern Europe networks of small and medium enterprises are emerging. In several cases, local governments are hoping to deepen those networks and districts through explicit regional and industrial policies to sustain economic growth and development. In so doing, these state and regional government agencies are explicitly modeling their efforts on Italian 'industrial districts' in the 1970s and 1980s. Concomitantly, Italian firms have recently been extending their investments in key places in Central and Eastern Europe, and in doing so they have been working to implement an 'Italian style' management, organization and quality standards they see as essential to effective industrial strategy. The dissertation analyzes the relationship between these two phenomena through interviews with representatives of Italian businesses abroad and regional and national institutions in Eastern Europe. Combining the qualitative data of the interviews with quantitative data concerning the trends in economic development and foreign investments at regional and local level, this research contributes to a better understanding of the relations between economic policy and patterns of investments in the region.

The definition of Eastern Europe adopted in this work comprises: the Central Eastern European countries (CEECs), which either joined the EU on May 1st 2004 or have an accession agreement with the EU, and the Western CIS (Ukraine, Belarus, Russia and Moldova), currently not participating in the EU enlargement. This regional focus permits a better understanding of the impact of the EU enlargement on outsourcing by comparing the different institutional environments in neo-EU, or candidate vs. non candidate countries. This regional focus will also allow the research to analyze two different stages of outsourcing. In the CEECs massive flows of investments took place in the 1990s, and the networks of foreign producers are already well established in the area. However, the expansion of the EU creates the expectations of wage rises, and the expected stability of wages in some areas of the Western CIS is leading to the beginning of a new wave further East (Smith, Buček, Pickles, and Begg: 2003).

Research method

This research presented specific problems concerning the collection of quantitative data on the activity of Italian firms in Eastern Europe. Particularly statistical data (EU notwithstanding) are still heavily dependent from nation-state institutions. Italian firms abroad and their subcontractors are legal entities of the host countries, but deeply linked with Italy, therefore they fall into a grey zone of difficult data collection. Data do exist, but they are difficult to recover and homogenize. The best data bank of Italian entrepreneurship abroad is ICE Reprint, based on the survey of 14 thousand Italian firms using instruments of support for internationalization (Interview Dr. Giovannetti, ICE Study Research and Statistics Office, director, 10-10-2006, language: Italian). However, the data bank is not available to the public – and the access would be very expensive, out of the reach of the budget for this dissertation. Moreover, focusing on the firms using the Italian State mechanisms of support for internationalization, it omits a large number of firms. Other significant data are collected by the associations of Italian enterprises abroad, the Italian chambers of commerce abroad and the banks. However, for privacy reasons, these data are reserved the members of the associations. Moreover, there are no standard criteria according to which the data are collected by the various associations.

Therefore, my method focused of the collection of qualitative data through snowball interviews. The result is an 'ethnography of the powerful' which evidences the position of Italian textile and clothing manufacturers in the broader picture of the neo-liberal transformation of Eastern Europe at local level. Following existing transnational networks of service firms and the value chains of Italian textile and clothing firms, this method highlights the new social spaces emerging from the activity of Italian firms in Eastern Europe.

Among the areas investigated, Bulgaria is characterized by a top-down effort of national and local institutions that are attempting to create industrial districts using Italy as a model. Timisoara (Romania) is the largest recipient of Italian investments in the textile and clothing sector, as result of a national strategy aimed at attracting foreign investments. The transborder region of Western Ukraine and Eastern Slovakia is witnessing the beginning of a new wave of investments: foreign firms based in Slovakia, but also Bulgaria and Romania, are beginning to move further East in response to the projected growth in the cost of wages and other factors as result of the enlargement of the EU. These three locations are characterized by very different conditions within which Italian firms are operating and within which local industrial districts are or are not emerging: EU membership/accession of the state vs. non-EU membership; successful districts vs. non successful districts, presence/ absence of local policies specifically aimed at the creation of industrial districts.

It had been a travel in a very concrete sense, since it involved reaching the fieldwork areas via land (car or bus) from Italy. University and research institutions in the host countries provided me with logistical support and help from colleagues and students to guide me in the local areas and interpreting from the local language when needed. The travel began in Northern Italy, in the town of Gorizia, which hosts Informest (www.informest.it), a public agency supporting Italian companies in their investments in Eastern Europe through the provision of real non financial services, scouting and dissemination of information about the opportunities in the area. Informest provides both services to business, organizing missions abroad, and participates in EU sponsored projects across the area. Being active part in the constitution of transnational institutional chains, with the personal support of its vice-president, Mr. Ugo Poli, I could access to connections throughout Eastern Europe as follows.

Slovakia. Informest correspondent for Slovakia is Dr. Vito Bovoli, entrepreneur, head of EDAS, a service firm supporting the internationalization of Italian firms in Slovakia, active since early 1990s. According to Dr. Bovoli, EDAS has provided services to about the 30% of the Italian firms that have re-located in Slovakia. Therefore, with his help I could identify a large portion of the Italian FDI in the textile and clothing sector in Eastern Slovakia. Through the connection with the Economics University in Bratislava I could access to the local government, national level agencies and trade unions. Ms. Suzana Lyenova, Slovak director of one of the Italian firms indicated by Dr. Bovoli, offered the possibility to access her own network in the town of Kralovsky Chlmec, which constitutes a case study because of the very high impact of Italian owned and Italian Slovak joint ventures in the town's total employment. EDAS is part of another transnational network: IC & Partners, a consortium of Italian service firms (lawyers, certified accountants, business consultants) which has been establishing itself throughout Eastern Europe, which constituted another network I could tap into.

Bulgaria. In the framework of VICLI, an EU sponsored project having the goal of "the identification of proposals aimed at enhancing the social environment and the territorial organization of industrial districts, included those emerging in candidate Countries of Central and Eastern Europe." (VICLI, *electronic document*,) Informest worked in partnership with the Foundation for Entrepreneurship Development (FED: www.fed-bg.org), a Bulgarian think tank supporting the emerging private sector. Mr. Pavlov, Chairman of the Advisory board, provided me with contacts in the Bulgarian Ministry of the Economy and with the local authorities in Rousse. In turn, they gave me the contact of Ms. Katia Goranova, a local leader and Executive Director of the Business Support Center for Small and Medium Sized Enterprises in Rousse, who allowed me to meet the local firms. Through the Italian Chamber of Commerce in Bulgaria I could have contact with the country manager of the Miroglio Group, the largest Italian investment in the textile sector in Bulgaria. Through Miroglio's country manager I could contact the Italian Consul in Plovdiv, and have access to two large investments there.

Romania. Informest provided me with contact in CPL92, an Italian service firm active in Romania since the early 1990s. Through them I could meet the Bucharest representative of Unimpresa Romania, the largest Italian enterprise association outside Italy. Through Unimpresa, I could meet the local branch representative of Boscolo & Partners, the local partner of the IC & Partners group, who in turn gave me the contacts of the Italian firms in the textile and clothing sector in Timisoara. Informest provided also the contact with the Group of Applied Economics (GEA: www.gea.org.ro) which provided a orientation on the landscape of the most relevant local institutions in Timisoara as far the economic development of the city and its county and attraction of FDI, which I could in turn contact with the help of my local research assistants, Livio Tudose and Maria, at the time undergraduate students at the 'West' University in Timisoara.

Ukraine. In Ukraine, being outside of the geopolitical space of the European Union, the networks I have been following in my research simply vanished: neither support from Informest or IC & Partners, nor logistical help from local universities was available. However, with a dynamic that confirmed the hypothesis developed during the proposal, Italian firms are stepping from their investments in the areas of the enlarged EU into the Former Soviet Space. Therefore, I could follow the networks established by firms. Particularly, I had two firm-based channels to enter Ukraine. The director of a large Italian owned clothing firm in Slovakia provided me with the contact of the director of TexUcraina, a daughter company recently established in L'vyv. After interviewing TexUcraina, I didn't pursue further research in L'vyv, because of the very high cost of lodging. In the meanwhile Ms. Lyenova (my access to the community of Kralovsky Chlmec), who is supporting her Italian bosses to establish a new investment in Ukraine, put me in contact with her Ukrainian counterpart, who is also interpreter and economist in a large Italian owned clothing manufacturing firm in Zakarpattya *oblast'*. The Italian responsible for that investment, Dr. Marzio Conte, allowed me to access a rich network of contacts among Italian owned, Italian-Ukrainian joint ventures and local authorities at municipal level within the Zakarpattya *oblast'*.

The steps of the fieldwork research are summarized in Table 1. The results of the research are represented in Table 2 and 3. They are as follows: eighty six interviews (eighty one in the field plus five background interviews in Italy), in one hundred and thirty days effectively spent in Eastern Europe. I balance to spend between five and six weeks in each country (except for Western Ukraine, that I considered belonging to the same research area as Eastern Slovakia, therefore I limited the presence there to twelve days). The time was spent quite evenly between the capital cities (where I conducted interviews with national level institutions) and the local areas of fieldwork. The good combination of institutional and academic support allowed a satisfactory productivity (i.e. the number of interviews per each day in the field, which include weekends), ranging from 0.55 for Slovakia and 0.69 for Bulgaria. The professional categories interviewed include: firms (thirty eight interviews), local institutions (eighteen), Italian institutions and associations abroad (eleven), consultants/think tanks (eight), Italian banks (three), local trade unions (three).

Table 1 Research in action

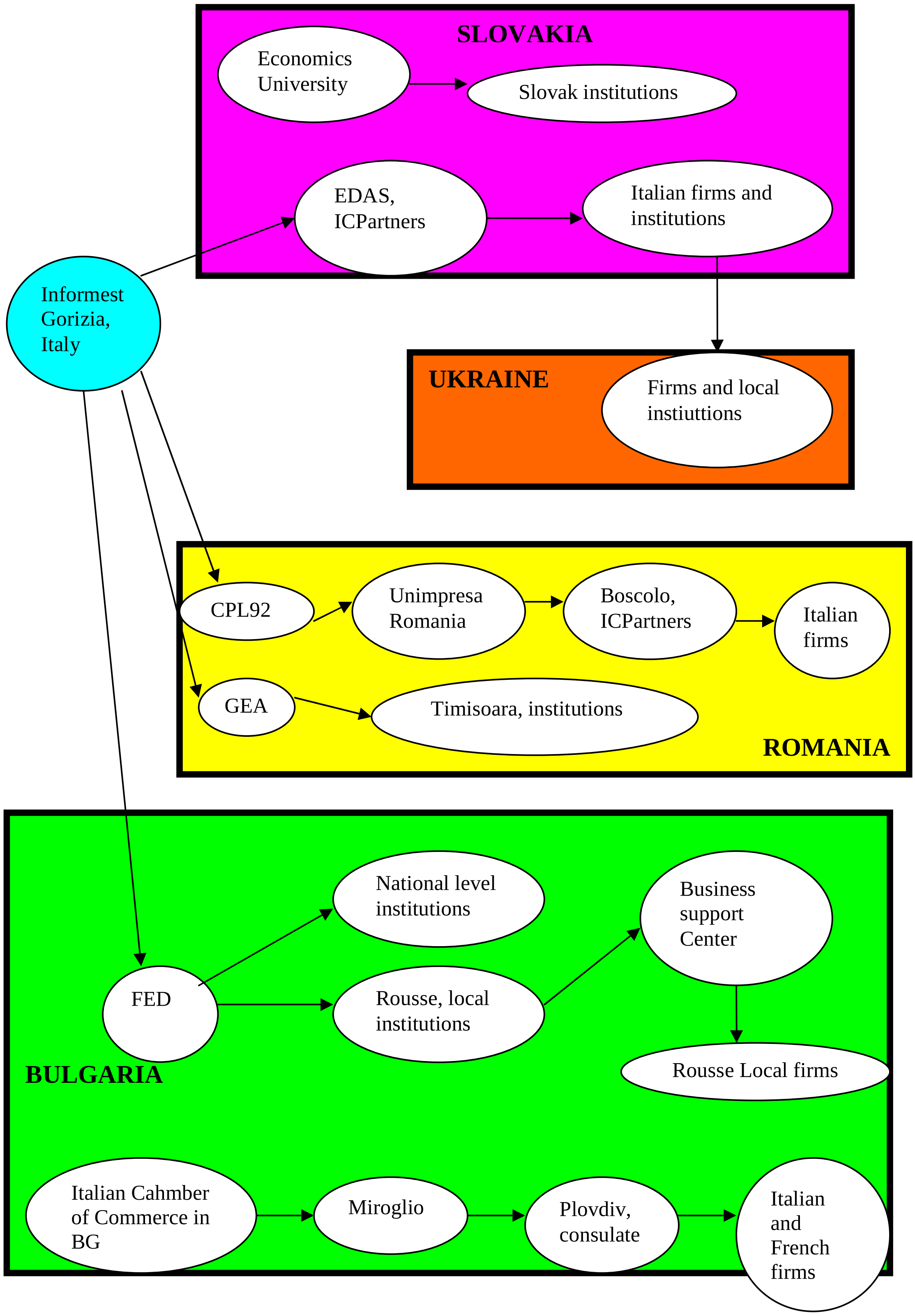
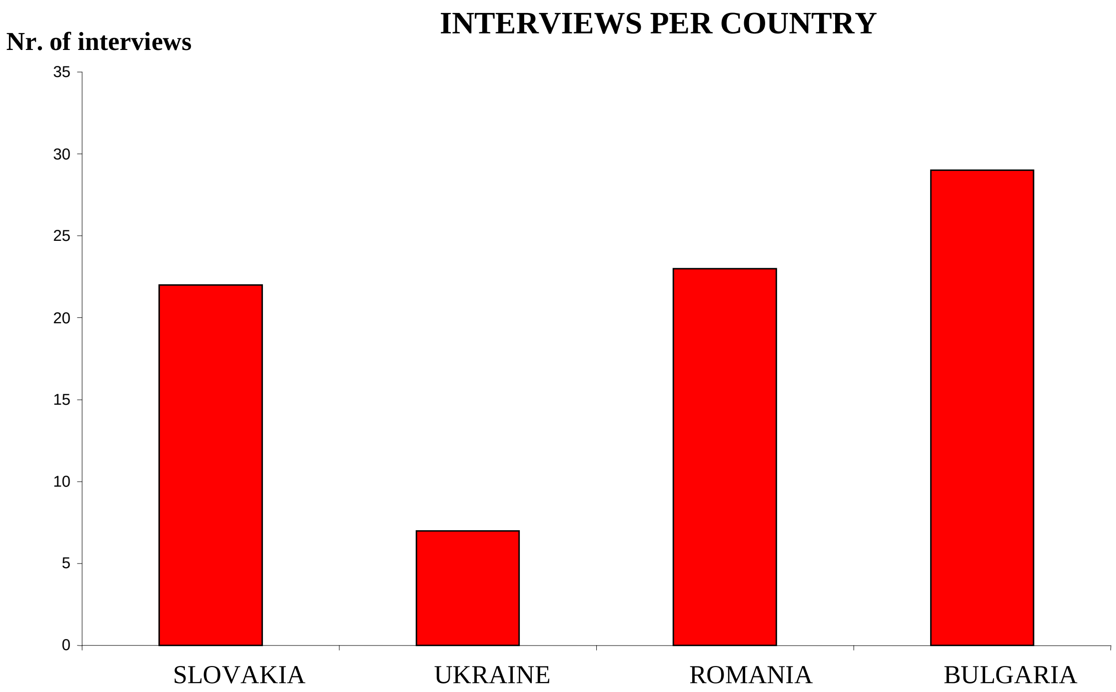


Table 2 Interviews per country and professional break down



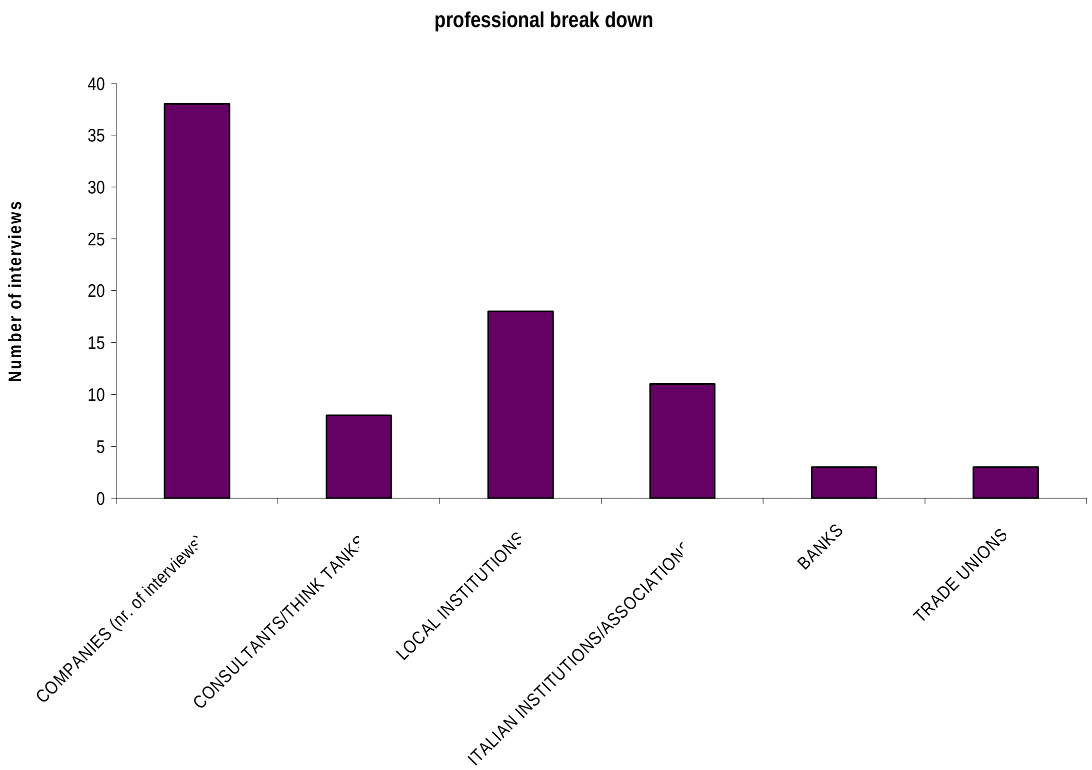
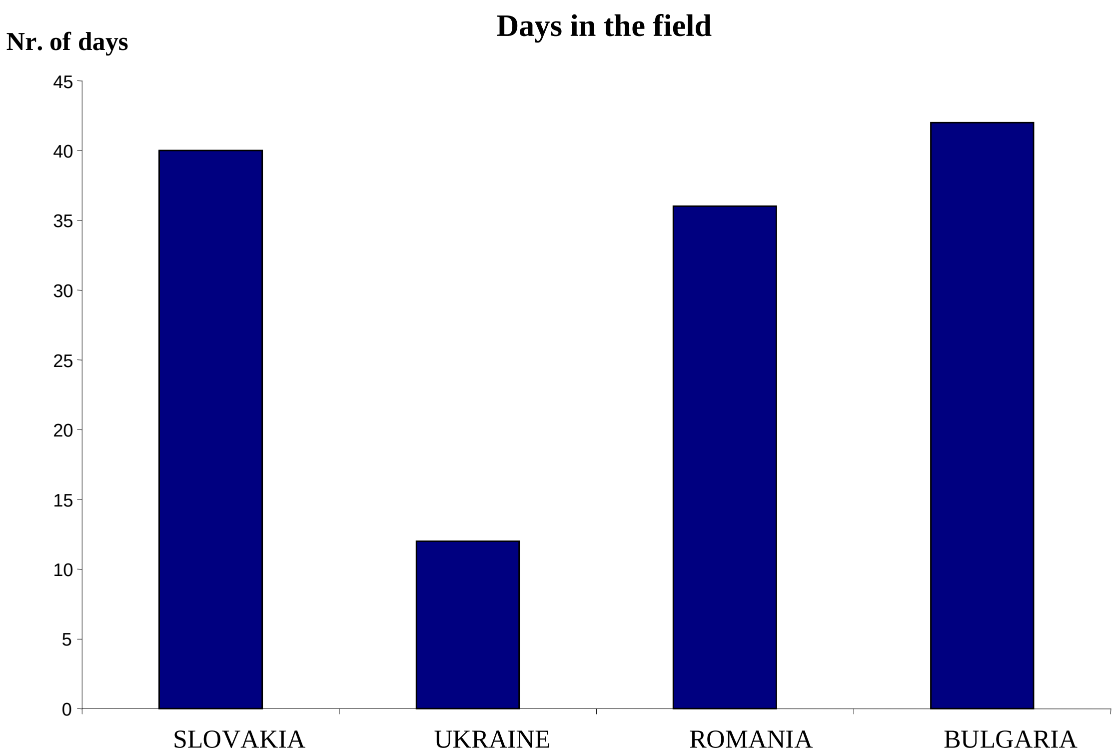


Table 3 Days in the field



Chapter outline

Chapter 1 discusses the literature on Neo-regionalism and Global Value Chains. In so doing, the first aim is to position this work in the on-going debate on the transformation of Italian industrial districts and their growing internationalization as consequence of increasing competitive pressure. The second aim is to show the interconnections between the Anglo American and Italian literatures. In order to include the work of Italian scholars, I am using in this dissertation in the Anglo American scientific debates. The third is to highlight the broader questions behind these literatures, questions that can find new answers and new elaborations through this work. The chapter begins grounding the dissertation research in the current debates of the Anglo-American geographical tradition. Then, it analyzes the relationship between such tradition and the Italian schools of thought on Industrial Districts. In so doing, it describes the role of Alfred Marshall's thought in providing a theoretical common base upon which the co-operation between Italian and Anglo-American schools has been built. The chapter highlights the co-operation that emerged between the English speaking and Italian speaking academia. In the 1980s and 1990s American scholars used the 'Italian case' to analyze the crisis of Fordism and the emergence of new forms of regulation within the capitalist economies. In turn, Italian scholars gained a broader access to international journals and to the English speaking academia. The theoretical differences between the two schools are evidenced as well. Particularly, the Anglo American schools developed their understanding of region in a top down process. They start from the global level, trying to find a general theory able to explain the post-Fordist regulation of capitalism (Piore and Sabel) and the mechanisms of de-verticalization (California School). The Italian approach instead is more limited in scope, focusing on systems of small firms in localized areas within Italy, searching for a unit of analysis located between the firm and the whole industry (Becattini) or multiple paths of technological development (Brusco). Reviewing the last decade's development of the two schools, the chapter highlights the emerging critiques, but also the engagement between the American and Italian literatures on regional development and the Global Value Chains approach.

The chapter concludes describing how both literatures on industrial districts and global value chains are used to analyze the internationalization of the Italian industrial districts. It highlights some of the problems of the current debate, and particularly the difficulty in applying a Global Value Chain approach – built on examples from multi national companies - to Italian small firms and the poor analysis of the influence of State and financial institutions, both in Italy and overseas, on internationalization of Italian firms.

Chapter 2 addresses these problems by discussing a spatial model for the internationalization of Italian industrial districts, with specific reference to Eastern Europe. The chapter highlights that, in Eastern Europe, social spaces emerge as joint consequence of the actions of firms, financial institutions and government institutions that co-operate thanks to the funds and programs financed by the European Union. Basically, international social networks and trust is established among firms and between firms and institutions as consequence of both foreign investments and EU-sponsored initiatives in the realm of economic co-operation. This personal trust, together with the harmonization of rules and regulations, is a key factor in allowing small enterprises – constituting the backbone of the Italian economy - with a small endowment of human resources and capital, to go international.

Chapter 3 discusses the support structures for the internationalization of Italian firms, namely Italian banks and service firms overseas. It highlights the joint role of transformations within Italy, post socialist transformation in Eastern Europe, and EU enlargement in determining the geography of internationalization of Italian banks and services. For the above mentioned issues, Eastern Europe has become the privileged area for the overseas expansion of Italian banks and services. In turn, banks and services constitute a non exclusive form of support for Italian manufacturers; i.e., manufacturers do have advantages in working with Italian banks or services overseas, because of bi-lingual services and easier credit rating, but they are not bounded by contracts to work with them.

Chapter 4 analyzes the area with the highest concentration of Italian firms overseas, Timisoara (Romania). The chapter focuses on the description of the relations between Italian firms, local firms and local institutions, showing how personal trust relations, together with a mix of geographical and structural factors, constituted the initial pull towards the area. It describes the evolution of the Italian presence in the area, in which low capital and low tech investments were followed by heavier, longer term and high tech investments. The chapter also shows the ways in which local institutions took advantage of the opportunities offered by the presence of foreign investors to support the development of local firms, initially trying to imitate the Italian model, and later developing their own model, based on the development of local infrastructures plus an effective attraction of European Union funds, obtained working in partnerships with city and regional institutions in Western Europe. In turn, this improvement is attracting larger foreign investments, and pushing the low capital and low wage oriented productions towards poorer areas in Romania.

Chapter 5 discusses the investment of the Miroglio group in Bulgaria in the context of national development policies openly inspired to the Italian model of industrial districts. The chapter traces the ways in which EU sponsored institutional co-operation has been used by local and national government to attempt to increase the economic impact of networks of small firms. The chapter highlights the ways in which Bulgarian actors adapted the concept of 'industrial districts' to the local tradition and experience, and the ways in which co-operation with regional level institutions in Italy is being used. It also detects a lack of involvement of Italian firms in this process, notwithstanding the fact that the Miroglio group is developing backward and forward linkages, bringing to Bulgaria its own experience of inter-firm co-operation, developed in several decades of work within the Italian industrial districts.

Chapter 6 compares the conditions of Italian firms in Eastern Slovakia – within the European Union – and Western Ukraine – outside the sphere of EU enlargement. More specifically, it compares two small sized towns (Kralovsky Chlmec in Slovakia and Tyachev in Ukraine) where Italian firms have a relevant impact in manufacturing employment. The chapter highlights the impact of an EU versus non EU environment on firms' strategies and behavior. Particularly, it highlights that EU membership brings about a better business environment, but also an increase in wages and utilities costs. Therefore, low cost manufacturing is being pushed towards Ukraine, but at the price of having to adopt strategies to cope with a more difficult environment. These strategies and their consequences on firms' investments and outsourcing patterns are described.

The conclusion summarizes the theoretical and empirical findings of the research.

Chapter 1
From industrial districts to the internationalization of firms: the co-evolution of Anglo-American and Italian literatures on small firms

1.1 Outline

On the very beginning of his recent paper on the restructuring of the Italian textile and clothing industry, Micheal Dunford stated that “In recent years there have been few academic analyses of Italy’s textile and clothing industries … of these studies, most have dealt with the recent delocalization of economic activities to Central and Eastern European countries … conversely, a vast academic literature has dealt with textile, clothing and other industrial districts” (Dunford, 2006: p. 27). Dunford is the latest of a long lineage of Anglo-American scholars who published extensively on Italy, beginning with Piore and Sabel in the 1980s, to Locke, Putnam, Scott and Storper in the 1990s to quote just a few. All these scholars have analyzed, in a way or another, the Italian industrial districts, i.e. “dense concentrations of interdependent small and medium enterprises in a single sector and in auxiliary industries and services” (ibid). The fundamental characteristics of industrial districts have been first identified by Alfred Marshall, who argued that “districts are driven economically by three mechanisms: (1) scale economies, which result from an high degree of specialization and division of labor; (2) external economies, which arise from the existence of shared infrastructures, services, and information and (3) the availability of special skills and the pooling of the labor force… Marshall also argued that districts are not simply an economic phenomenon: they have an industrial atmosphere that itself involves the interaction of the economic and social system" (ibid.).

One of the consequences of this scholarship is that the Italian economy has been known in the international academia mostly because of these systems of small firms, even though recent work by Dunford and Greco (2006) showed that the vitality of the Italian economy is guaranteed by the coexistence of a multiplicity of economic sub-systems, of which industrial districts are just one among many. However, looking at this bias from a different angle, the success of a set of ideas and theoretical claims developed around the concept of 'industrial districts' is highlighted. Prof. G. Becattini published a seminal article in 1979 (reprinted and translated into English as "Sectors and/or districts: some remarks on the conceptual foundations of industrial economics" in Goodman and Bamford (eds.): 1989), in which he used the concept of 'industrial districts,' to analyze the development of small firms in Tuscany. Since that article, the Florence and Modena schools of thought on industrial districts developed in Italy in the 1980s and 1990s: Becattini, Bellandi, Dei Ottati in Florence, Fabio Sforzi in Turin (see Becattini et al.: 2003 for a synthesis of the work of the Florentine school), and Sebastiano Brusco (1982) in Modena. As early as the 1980s, Piore and Sabel (1984) brought the case of the 'Italian industrial districts' to the attention of the Anglo American academia, attention that had grown through the 1990s, especially thanks to the work of geographers Allen Scott and Micheal Storper.[1]

The intellectual co-operation between Anglo American and non English speaking scholars is not common in human geography. Notwithstanding the growing hegemonic role of the English language in the discipline (see Short *et al.*: 2001), Gutierrez and Lopez-Nieva (2001) have argued that the international journals in the discipline have achieved a low

[1] See Scott: 1986 and 1988; Scott and Storper: 1987 and 1991; Storper: 1997

degree of success in including the work and ideas of scholars belonging to traditions other than US and British. Instead, the ‘success’ of literature on industrial districts represents a counter-trend, in which a set of ideas developed within the Italian speaking social sciences has traveled into the debates of the Anglo-American geography.

This chapter investigates the conditions leading to, and the outcomes of, this intellectual cross-fertilization between the various Italian schools of Industrial Districts and the Anglo-American geography. In so doing, the chapter asks three research questions: 1) what are the theoretical similarities and differences between the two traditions? 2) How did the changes in the Italian and world economies affect the co-development of the two literatures? 3) How are the two literatures changing in the 2000s? In answering these research questions, this chapter shows in which ways the literature on Italian industrial districts has evolved (see, for example, Chiarvesio and Micelli: 2006 [1] and [2], Corò and Volpe: 2006, Rullani: 2002) into including in its analysis the debates over the internationalization of the textile, clothing and other industries into Eastern Europe.

1.2 The ‘regional turn’ in the 1980s and 1990s and the work of Alfred Marshall as theoretical common ground between Anglo-American and Italian schools of thought

This section argues that Italian and Anglo-American scholars could establish a fruitful co-operation because of parallel developments in the realm of theory. Particularly, in both cases economic changes in both the US and Italy in the 1970s and 1980s led to an increased role of small firms as agents of industrial innovation and prosperity. In the 1980s and 1990s scholars in both countries began to notice that closely integrated systems of small firms were emerging in specific geographical areas, and not in others. This empirical fact led them to re-discover the 'region' as unit of economic analysis.

In both cases, the work of British economist Alfred Marshall (1842-1924) had an influence on this 'regional turn,' schematized in Table 1.1. In the case of the Italian schools, the influence is direct: Becattini is a heterodox economist who published extensively on Marshall in the early stages of his career. In his first book in 1962[2] he analyzed the concepts of industry and theory of value in Marshall and in early Twentieth Century scholars who drew on Marshall; later in 1975, he edited the Italian translation of *Economics of Industry,*[3] originally published by Alfred Marshall with his wife Mary Paley Marshall in 1879,[4] and in 1981 he edited a collection Marshall's essays.[5] In the 1979 paper on industrial districts, Becattini stated that the characteristics that allow certain areas to achieve and retain over time leadership in the industry depend from population density, infrastructures, professional traditions (that Marshall called 'industrial atmosphere') and the socio-cultural common background. Therefore, Becattini argued, the region, or 'industrial district,' and not the industry per se should be the unit of economic analysis.

In the Anglo-American schools, there is an in-direct influence of Marshall to the extent the work of Piore and Sabel, Storper and Scott and the various schools of thought that in the 1980s and 1990s put the region at the heart of the economic analysis were influenced by Becattini and the Italians. At the same time, Trevor Barnes (1997) shows that Marshall had a direct influence on the Anglo American economic geography, at least since the 1990s.

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[2] Becattini: 1962

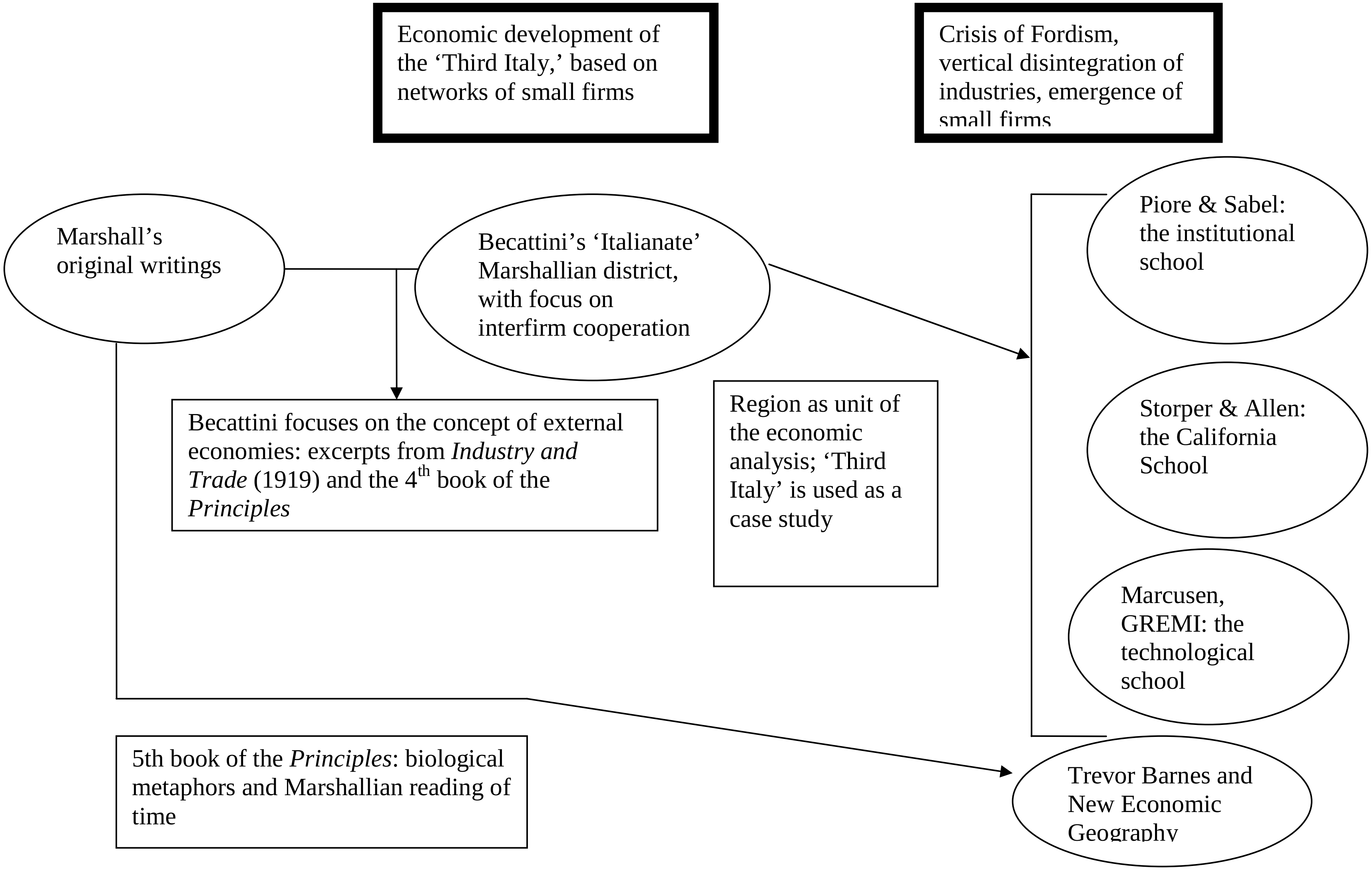
[3] Becattini (a cura di):. 1975

[4] Marshall A., MP Marshall: 1879.

[5] Becattini G. (a cura di): 1981.

This ‘drive towards Marshall’ emerged from the fact that new economic geography shifted away from the neo-classical understanding of the economy, and looked for new theoretical underpinnings. Instead of representing the economy as neo-classical economics does, i.e. a combination of forces independent from human agency and from any historical and geographical context, new economic geography considers human society, including the relations of production and consumption, in a way much more similar to a living organism, characterized by path dependency, influenced by contingencies, not necessarily developing towards the optimal practice. According to Barnes, a similar understanding of the economy traces back to some parts of Marshall’s work, especially in the way he developed the concept of industrial atmosphere, and in the way he critiques the neo-classical treatment of time. Marshall conceptualized a world of path dependencies, social reproduction of the economic practices and relations between institutions and firms that informs both the Anglo American tradition and the work of Becattini and his disciples.

Table 1.1: Role of Alfred Marshall in the Anglo-American and Italian schools of thought on regional economies and industrial districts



.2.1 Anglo-American Neo-regionalism

The instances leading to the regional turn in the Anglo American and Italian schools were different. In the Anglo American schools, the regional turn was closely related with the crisis of Fordism. In the R*egional World,* (1997) Micheal Storper pointed out that: "since new successful forms of production – different from the canonical mass production systems of the post-war period – were emerging in some regions and not in others, and since they seemed to involve both localization and regional differences and specificities (institutional, technological), it followed that there might be something fundamental that linked late 20th-century capitalism to regionalism and regionalization" (Storper: 1997, p. 3). This is a top down approach: analyzing the crisis of Fordism, Anglo American scholars 'discovered' the importance of the regions starting from a global perspective, looking for a general theory that could explain the diffusion of changes in the ways in which capitalism is regulated. The immediate consequence of this approach is that neo-regionalism looked for general rules, applicable to regions very different from one another and able to explain the mechanisms of emergence and success of flexible production.

Among scholars participating in the debate on regions as units of analysis of the post-Fordist economy, Piore and Sabel focused on the role of institutions. They wrote *The Second Industrial Divide* in 1984, in years in which the Fordist mode of production and the Keynesian approach to macroeconomic policies were in deep crisis, but the following neo-liberalist hegemony hadn't been consolidated yet. Piore and Sabel introductory chapter offers a portrait of that historical moment, in which the old system was in crisis, but the new one was not yet clear. They opened the book noticing a surprising agreement between neo-classical and neo-Marxist schools that the welfare state was actually damaging industrial development. Neoclassical economists sustained the traditional liberalist and Smithian argument that economic performance is maximized by free competition in the market, and that the attempts of the welfare state to manage the economy were obstacles to competition. From neo-Marxist side, it was pointed out that the welfare state had imposed “alien, proto-socialist forms of exchange over the capitalist economy” (p. 10). According to Piore and Sabel, the main reason of the difficulties to find a way out from the crisis, was the widespread agreement that mass production was the only efficient way to organize a market economy. Their thesis was to demonstrate the falsity of this assumption in order to find a way out to the crisis. Influenced by the French Regulationists, they interpret crises as moments in which the institutional circuits connecting production and consumption are no longer suitable to the necessities of the moment. At the root of the sharpest institutional crises, there is another kind of crisis, connected with technological change. They call the brief moments of choice influencing the path of technological development ‘industrial divides.’ For Piore and Sabel, the first divide was the establishment in the 19th century systems of mass production. Instead, the second industrial divide should be characterized by the crisis of mass production and the resurgence of small firms and craft production. Their analysis of the articulation between mass and craft productions is not dissimilar from Marshall’s: both point out that mass and craft are actually interdependent; Marshall stresses the fact that mechanization provides cheaper and larger numbers of components for crafts, while Piore and Sabel points out that the machinery for mass production is actually craft-made. They highlight the economic viability of agglomerations of small firms, due to institutional arrangement at local level. These arrangements balance inter-firm co-operation and competition, thus maximizing the efficiency of the whole district.

The California School, whose main exponents are Micheal Storper and Allen Scott, followed a different path for the re-discovery of the region. Their empirical work focuses on the apparel, high tech and entertainment industries in California. At the theoretical level, they focus on the reduction of transaction costs connected with the linkages among different companies. Allen Scott began studying the apparel industry in Los Angeles, theorizing the relation between division of labor, transaction costs and agglomeration (Scott: 1988). Storper and Christopherson (1987) described the shift of Hollywood from a vertically integrated to vertically disintegrated industry. Overall, the California School's thesis is that vertical disintegration is adopted to resist to market uncertainties, minimizing the risks of excess of productive capacity and maximizing the benefits of technological specialization. However, this implies that inter-firm transactions become more frequent, complex and less foreseeable than in one large integrated firm (i.e. their 'cost' is higher). Territorial agglomeration is the way in which those transaction costs are minimized.

The Technological School (Markusen, GREMI) studied the spatial distribution of high tech industries and the reasons why some regions are more active than others in developing such industries. In the USA, Ann Markusen (1986) worked on transformations of leader industries at regional level. More in general, the works of the technological school focused on the Silicon Valley and Route 128 highlighting the virtuous cycles of development between research institutions, companies and infrastructures. In Europe, the GREMI (*Groupement de recherche Européen sur les Milieux Innovateurs*) analyzed the reasons why some areas are more suitable than others to develop innovation. However, both the GREMI and the North American counterparts failed in explaining why, at parity of favorable conditions, some regions develop technology intensive productions and others do not.

Building on these three schools, and on evolutionary economics, in the *Regional World* Micheal Storper developed what he called “relational turn in regional development.” According to evolutionary economists, technology develops along trajectories determined by the interdependent choices of the actors involved. Mechanisms of transmission of non-codified practices link those trajectories with the territory. Storper puts at the heart of technological development interpersonal relationships, which bound the processes of innovation with the territory where the actors involved in innovation live and work. In so doing, he proposes to shift from an approach which “Continues to be controlled by the metaphor of economic systems as machines, with hard inputs and outputs, where the physics and geometry of those inputs and outputs can be understood in a complete and determinate way” (Storper: 1997, p. 28) to an approach in which “The guiding metaphor is economy as relations, the economic processes as conversation and coordination, the subjects of the process not as factors, but as reflexive economic actors, both individual and collective, and the nature of economic accumulation as not only material assets, but as relational assets” (Storper: 1997, p. 28).

At the heart of the turn there is the concept of untraded interdependencies, that Storper acquires form evolutionary economics, particularly from Eymard-Duvernay (1987), Thevenot (1986), *and Revue Economique* (1989). Untraded interdependencies are the implicit rules governing the interpersonal relations among actors involved in the economic processes. In sum, according to Storper, the transmission of non codified knowledge is possible in the regional agglomerations because cultural proximity leads to the homogeneity of these implicit rules. This approach allows Storper to re-interpret the concept of external economies, and to understand why agglomerations survive notwithstanding the development of information technologies: “In many circumstances, constraints of proximity seem to remain extremely important to the communicative, interpretative, reflexive and coordinative dimensions of transacting, where even e-mail does not substitute for proximity” (p. 44).

Untraded interdependencies shape potential course of action. Building on evolutionary economics, Storper links the trajectories of development of technology to the territory through the concept of untraded interdependencies. In this way, linking the temporal aspect of the trajectories of technological development with the spatial aspect of regions as privileged locus of untraded interdependencies, Storper can explain the reasons why different regions develop different, more or less successful, productive capacities.

1.2.2 The origin of the Italian school on “Industrial Districts”

In the 1980s, Italian scholars re-discovered the region following a different path of intellectual debate, originating from issues of industrial development within Italy. In the 1960s the debate was centered around the dichotomy between the developed North, where large, Fordist enterprises guaranteed (relatively) high wages, high productivity and innovation, and the under-developed South, where production was based on small, low wage and inefficient firms (Lutz: 1962; Graziani: 1972). Later, Garofoli (1978) began to pay attention to the role of small firms as source of innovation. At the same time, Bagnasco (1977) put into question the dichotomy between North and South. He individuated an area that did not fit into the usual North-South divide, stretching from the North East (Regions Veneto and Emilia Romagna) to the Center east along the coast of the Adriatic Sea, which he called ‘Third Italy.’ This area was characterized by economic dynamism and rapid economic growth; however industrial production was organized under a system significantly different from the Fordist model of big enterprises and mass production of the North West. This system was described as networks of small firms, serving the large agglomerates of the North West (Rabellotti: 1997). Other peculiarities that scholars identified were the regional rural and artisan tradition, the common social background of workers and entrepreneurs, and the family as central unit of the enterprise (Fuà: 1983).

Rooted in this intellectual environment, Giacomo Becattini took the intellectual challenge to find a unit of analysis suitable for empirical research of these new conditions of industry. At the time, he was the most suited scholar to do it: his first book (Becattini: 1962) analyzed the different ways to conceptualize industry. His experience as Marshallian scholar brought him to the re-discovery of the Marshallian industrial districts. Becattini arrived to the industrial districts reasoning on the problematic relation between the construction of theoretical models and applied research. He criticized unidirectional fluxes of ideas in which theoretical economists produce models that are then applied in empirical research. Particularly, he criticized those models that consider that actors in the economy can reach only one (rational) decision. To this kind of approach, he opposed an understanding of the economy based on multiple possible choices, in which firms do take 'irrational' and therefore 'unsuccessful' decision. In his vision, 'successful' and 'unsuccessful' firms, through their interactions are parts and parcels of the same dynamic systems. Therefore, he envisions a non-reductionist approach to economic theory, characterized by models able to capture complexity, and a theory building approach based on continuous feedbacks between theory and applied research.

Becattini wrote his first article on industrial districts (1979) in order to find an explanatory model for the development of third Italy in line with these characteristics. He noticed that Marshallian industrial districts captured a complex web of relationships operating at the level of large groups of interrelated industries. Shifting the unit of analysis to the territory, he could summarize in one concept (the district) the following issues characterizing the economic success of Third Italy. First, the economies of scale given by a large number of small producers specialized in a narrow phase of a larger production process integrated at territorial level, which are similar to those realized in large vertically integrated factories. Second, those agglomerations of producers allow further investments in inputs, machinery supplies and real services to the industries. Third, the concentration of people employed in the same industry leads to higher quality of labor, informal professional training and circulation of ideas leading to innovation. Fourth, the social cohesion of the local areas is preserved by the development of infrastructures and by long standing traditions and shared identity in the population.

Probably, Becattini's ideas would have remained an intellectual exercise within the University of Florence, with some spin offs at the level of the Tuscany's regional government– since he is one of the founders and first director (1968-1973) of IRPET, the Regional Institute for Economic Programming of Tuscany (Raffaelli: *electronic document*) – if some external contingencies would not have intervened. The key issue for the (intellectual) success of the Italian School of Industrial Districts was the exceptional (financial and productive) success of Third Italy in a national and international context of slow economic growth.

In the period following the 1973 oil crisis, the rates of economic growth of the advanced capitalist economies were slower than in the previous thirty years. Italy was not an exception, considering that the traditional industrial core of Italy – the North West of the country - slowed down and the South did not take off. In this situation, small firms of Third Italy (until 1990s) were a counter-trend that allowed Italy to perform better than many other capitalist countries (Dunford and Greco: 2006). This situation gave international visibility to the scholars working on industrial districts. Because of this success, Anglo American scholars looking for alternatives to Fordism began to pay attention to the Italian case; relationships were established between the neo-regional scholars and their Italian colleagues. Because of the visibility of the Italian case and the help of the foreign colleagues – which has paramount importance to be able to produce scientific work in a second language and following a different tradition of editorial standards – some Italian scholars could publish in English speaking journals. This fact gave Becattini, Sforzi, Garofoli, Dei Ottati, Bellandi and – later – Paniccia (2002) and Rabellotti (1997, 2004), Guerrieri Iammarino and Pietrobelli (2001), Cainelli and Zoboli (2004) international visibility, which reinforced their position in Italy. This popularity, together with the fact that research on industrial districts in Italy has been connected with policy making since the beginning (see, for example, Brusco: 1990) allowed the discourse on industrial districts to go beyond academia and inform a wide range of policies in Italy and beyond.

1.2.3 The Florentine School and the Modena School

Following the success of Italian small firms, two main schools of Industrial Districts emerged: the Florentine School, around Becattini and his disciples, and a Modena School, around the work of the late Sebastiano Brusco. In English, a summary of the work of the Florentine School is *From Industrial Districts to Local Development. An Itinerary of Research* edited by Becattini, Bellandi and Sforzi in 2003. The Florentine School is a well organized working group, which has its own annual meetings (*Incontri Pratesi*) and a journal, *Sviluppo Locale*. The following distinctive issues can be recognized in the school's work: the theoretical Marshallian basis, the progressive shift from the concept of industrial district to 'local development' and the quantitative method for the study of industrial districts built by geographer Fabio Sforzi.

The school focuses on the institutional dimension of the districts, emphasizing the ways in which districts are organized. Progressively, the school extended its analysis to areas not recognizable as 'industrial districts.' Three intuitions are at the root of this shift from 'industrial districts' to what Becattini called 'local development' (Becattini, Bellandi, Sforzi: 2003, chapter 10): a) industrial districts are an example of a development path based on small firms; b) they are not the only possible concretization of this path; c) the Italian economy has been shaped by several paths of local development. Concretely, with this shift the Florentine School has recognized that the classical model of Industrial Districts, as outlined in the early work of Becattini, is not the only way in which systems of small firms in Italy are organized. In so doing, they responded to emerging critiques, that pointed out the distance between the model of Industrial Districts and the concrete case studies of districts outside Tuscany (see for example, Rabellotti: 1995) At the same time, in years in which the Anglo American economic geography was abandoning the use of formal models, Fabio Sforzi – still influenced by the quantitative revolution - developed his spatial model of distribution of the districts. Although this model has important limits (see Paniccia: 2002) it has been accepted by the National Institute of Statistics (ISTAT) and became the roots for the policy initiatives and mapping of the districts.

The most important scholar of the Modena School was Sebastiano Brusco (1934-2002), who had an approach to industrial districts remarkably different from Becattini's. He developed his vision of industrial districts from empirical research on the metalworking industries in Emilia Romagna (Brusco: 1975 and Brusco et al.: 1979). In the early 1970s he challenged the dominant view among economists, according to which innovation in the metal mechanic sector is linked with scale economies. Therefore, only large firms should have been innovative. He built his theory on the work of economist Piero Sraffa (1925, 1926). Charles Sabel (2004) summarizes Brusco's approach as follows: "From Sraffa's demonstration that interest rates did not determine a unique choice of technology he drew, with evident pleasure, the heterodox, ultimately un-Marxist conclusion that at any stage of development different bundles of machines and institutions—small factories as well as large, to cite the crucial example—could be equally efficient."

This approach highlights the positive outcomes of technological and organizational variety, thanks to which large and small firms can be equally competitive. In Brusco's work there are two recurring main themes: first, he kept challenging organizational and technological uni-directionalism throughout his entire career (as in Brusco: 1997). Second, he investigated extensively the relationship between firms and State institutions, in order to understand the best ways to support to the economic competitiveness of the districts. Particularly, Brusco noticed that districts have to constantly update technology and knowledge of the market in order to remain competitive. Throughout his entire life, he worked to define the best industrial policies for the support of innovation and competitiveness in the districts. An example of this scholarship in English is the paper "The Idea of Industrial Districts: Its Genesis" in Pyke F., G. Becattini, W. Segenberger (eds.)

1990, in which he distinguished between those districts that emerged spontaneously, without any State intervention, and those showing “a need for intervention which either did not exist before, or was at least less evident. The underlying contention is that new markets and new technologies have developed since the beginning of the 1980s, posing a problem for both large and small firms” (p. 16).

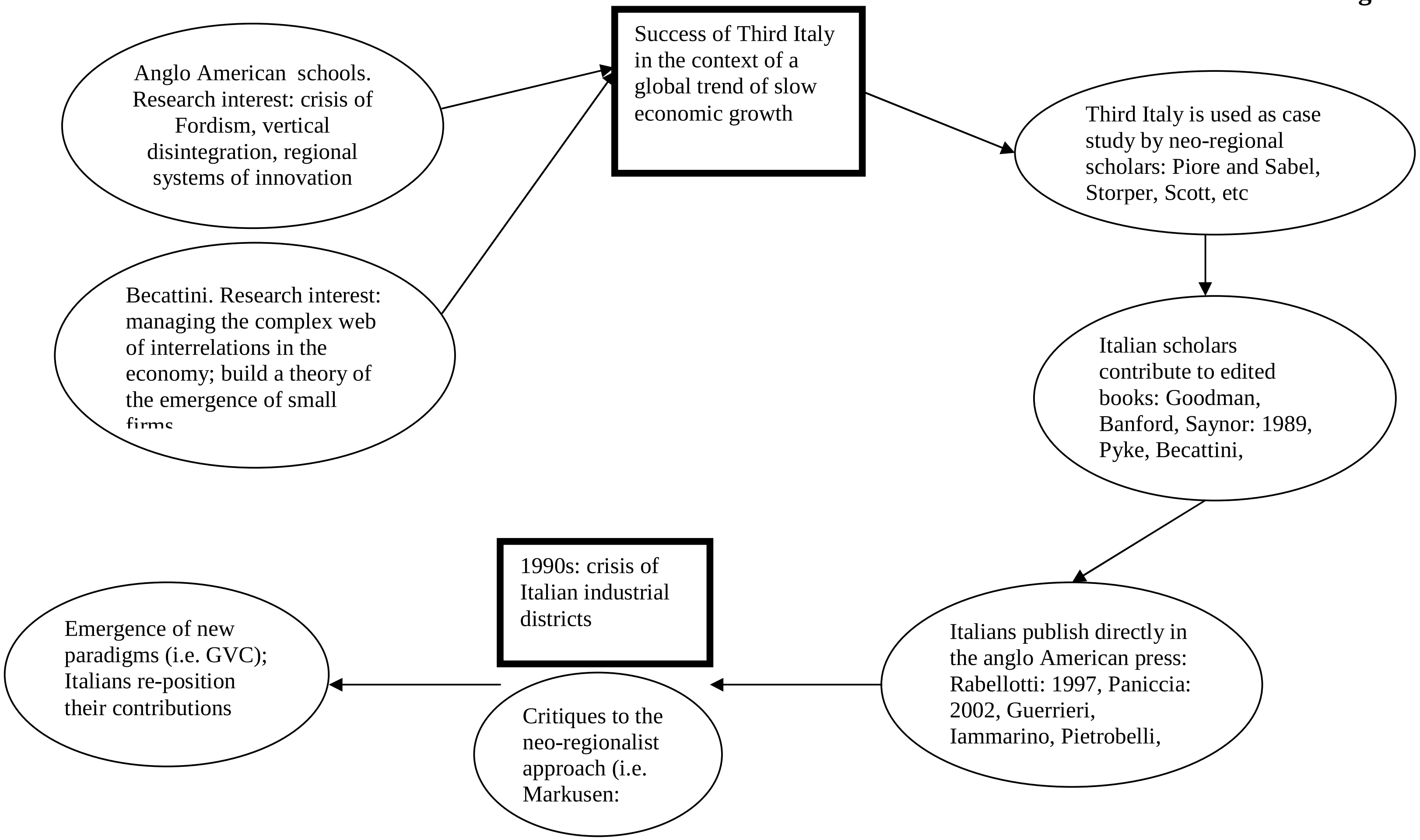
1.3 Differences and analogies between Anglo-American Neo-regionalism and Italian Industrial Districts

The analogies between Anglo American Neo-regionalism and Italian schools of Industrial Districts in terms of theoretical approaches and subject matter have been strong enough to allow Italian scholars to publish in the Anglo-American academic press. The publications were preceded by the establishment of interpersonal relationships and intellectual exchanges among scholars. An example of these exchanges is an article on *Rivista Geografica Italiana* from Cristina Capineri (1987). This was the first article on a leading Italian geographical journal on the topic of industrial districts. The article introduced the topic of industrial districts in the Italian geography by using the work of Allen Scott on Orange County California, instead of using the work on Italy from the Florentine and Modena schools. At the same time, Allen Scott and Micheal Storper (Storper and Scott: 1989) were introducing Italian examples in their work. Particularly, they were developing an argument that “took what seemed to be the fact in the Italian cases and created an economic model of the agglomeration process… drawing on the example of technology development in Sassuolo documented by Russo and extending this to our Californian case” (Storper: 1997, p. 9 and 11).

The mechanisms that allowed turning these exchanges into publications are summarized in Table 1.2. After Piore and Sabel brought the Italian case to an international audience, Italian scholars began to contribute to edited books. Examples of these early steps are *Small Firms and Industrial Districts in Italy* (Goodman, Banford Saynor: 1989) and *Industrial districts and inter-firm co-operation in Italy* (Pyke, Becattini, Segenberger: 1990). These early works had a very ambitious scope, in which the Italian model was studied in order to understand whether or not “Industrial districts do indeed constitute a blueprint for the regeneration of local and regional economies” (Amin and Robins: 1990).

Later, the Italians were able to publish autonomously in the Anglo American press. Rabellotti (1997) first noticed the discrepancies between Becattini’s model and concrete case studies. She was the first to detect the phenomenon of de-localization of production abroad, which she connected with a social and economic crisis within the district. Guerrieri, Iammarino and Pietrobelli (2001) included the multi national companies and global production networks in the discourse on the industrial districts, considering the reciprocal spillovers between multi national companies and districts, comparing small firms in Italy and Taiwan. Paniccia (2002) analyzed the research methods used to study the districts, and suggests some lines of research to improve the theoretical model of the districts. Cainelli and Zoboli (2004) showed the ways in which the Italian districts were responding to competitive pressure brought by globalization, modifying their structure through mergers, acquisitions and re-location of production abroad. Besides this, they noticed that firms in the districts were shifting from a model of innovation based upon tacit and informal knowledge towards a more widespread use of formal knowledge.

Table 1.2: Mechanisms of transmission of the idea of industrial districts between Italian and Anglo American schools of thought



Two main issues emerge from this analysis of the interactions between Anglo American and Italian schools. The first is the asymmetry of power between the two schools. Particularly, the key power issue is represented by the control of the most important scientific journals and publishers. As we saw, one of the most relevant opportunities opened to Italian scholars was the possibility to publish in international journals and edited books. This allowed them to be quoted by a much larger academic audience. However, the rules and the standards for publications in the best academic papers and publishers are the rules set within the Anglo American academia; therefore, Italians had to put themselves in a learning position. Besides this, the relevance of Italian schools abroad is quite tightly linked with the use of the Italian case by Anglo-American scholars. In turn, this depends from academic debates set within the British and American academia, to which the Italians are invited when their contributions fit into research agendas decided by their Anglo-American colleagues.

The second issue is that – notwithstanding the close relationship and the variety of schools – Italian and Anglo American approaches remain distinct. The most evident difference is that the Anglo American schools developed their understanding of region in a top down process. They start from the global level, trying to find a general theory able to explain the post-Fordist regulation of capitalism (Piore and Sabel) and the mechanisms of de-verticalization (California School). The Italian approach instead is more limited in scope, focusing on systems of small firms in localized areas within Italy, searching for a unit of analysis located between the firm and the whole industry (Becattini) or multiple paths of technological development (Brusco).

This narrower geographical focus shields the Italian schools from some of the problems that neo-regionalism must face. Particularly, the aim to apply the neo-regionalist approach to very distant (both in time and space) regions raises serious issues of both definition and method. Particularly, the concept of region has been applied to very different spatial entities, from areas as large as European states in North America to the micro areas of the Italian districts. As for methods, given the variety of conditions it is very difficult to collect homogeneous data for comparative studies. However, the Italian literature is not free from methodological and theoretical problems. In fact, Ron Boschma (*electronic document*) points out that the statistical method used by Sforzi and ISTAT to identify and map industrial districts has important weaknesses, especially because it does not capture inter-firm cooperation, which is one of the most important aspects of the industrial districts model. Also Becattini himself describes the theoretical and empirical research on industrial districts as a work in progress, whose concepts have not been organized in a full fledged theory yet (Maccabelli and Sforzi, *electronic document*). In the 2000s these weaknesses led to critiques and changes in both the Italian and Anglo-American schools.

1.4 Evolution of Neo-regionalism in the 2000s between critiques and emerging new approaches.

1.4.1 Evolution of Neo-regionalism in the years 2,000s

In the years 2000, consistent body of empirical research has been carried on building on the assumptions of neo-regionalism, a sample of which is summarized in Table 1.3. These papers have analyzed a wide range of geographical areas, sectors of the economy and forms of governance at regional and national levels. At the same time, some key papers developed a theoretical and methodological critique of Neo-regionalism. Lovering (1999) highlighted the failure of Neo-regionalism to contextualize regional economies in broader national and global trends. He also pointed out that this literature does not analyze the power relations within regions. MacLeod (2001) stressed the weak trans-scale analyses of Neo-regionalism – i.e. the mechanisms linking regional performances with broader shifts in national and international policies. Markusen (2003) pointed out that the key concepts of Neo-regionalism – region, regional economy, industrial district, cluster, etc. – are often ambiguously defined (fuzzy concepts). At the same time she highlighted that methodological weakness – which she identified with the poor discussion of the research methods and the widespread use of not-reproducible case studies – is widely spread in this literature. Markusen linked fuzzy concepts and methodological weakness stating that “Perhaps one reason why regional scholars have found it easier to promulgate fuzzy concepts is that the literature has become increasingly permissive about the quality of, and the necessity to, include evidence in published research” (Markusen: 2003, p. 704).

These weaknesses notwithstanding, Neo-regionalism is still a widely used approach. One way to interpret this success is through considering trends and evolution in the world economy. The original formulations of Becattini and Piore and Sabel focused on the success of systems of small firms as leaders in innovation and lean production. Instead, in recent years Harrison (1997) evidenced how big businesses, after a decade of crisis were able to combine lean production with the advantages of being ‘big’ – i.e. economies of scale, resources, direct knowledge of markets, and possibility of political pressures on the state. Neo-regionalism acknowledged this shift, and changed its focus from systems of small firms to the overall performance of regions. At the same time, processes of regional concentration of manufacturing activities increased, at least in Europe (Ezcurra, Pascual, Rapun: 2006), while evidence from the United States shows that spatial bounds to knowledge transmission – and therefore industrial clustering - are still present, although weakening (Johnson, Siripong, Brown: 2006). This empirical evidence of industrial clustering, together with the awareness that the resurgence of regions is a consequence of globalization and the weakening of the nation state, adds relevance to the theoretical work of neo-regionalists. Besides this, a consistent body of policy interventions supporting industrial agglomerations has been put in place (see, for example vom Hofe, Chen: 2006 for an overview of cluster policies in the USA, and the EU project INNOVA (www.europe-innova.org) for a mapping of clusters within the EU).

Having survived the sharp criticisms, Neo-regionalism has found some security in approach and interest, and a stable role within critical economic geography. A recent critique of neo-regionalism by Hadjimichalis (2006, p. 690) summarized the positions of the whole neo-regionalist vein of research as follows: “In the current debate on local and regional development and after several ‘turns,’ dominant critical models have found some security in institutional, cultural and evolutionary approaches. Currently success, competitiveness and their reproduction in a few paradigmatic regions are the center of interest of Neo-regionalism. A distinctive feature of these regions and places is the embeddedness of certain non-economic factors such as social capital, trust and reciprocity based on familiarity, face-to-face exchange, cooperation, embedded routines, habits and norms, local conventions of communication and interaction, all of which contribute to a region’s particular success.”

Table 1.3: Sample of empirical studies on regional economies

Main question these papers ask: Do productive agglomerations have a positive influence on firms within the agglomerate?

Answer:

NO

AUTHOR	MAIN ARGUMENT: the value of productive agglomeration has been over-estimated because:
Coel and Townsend (1998)	Emphasis on manufacturing firms, and the excessive weight given to local sub-furnitures, markets and partnerships
Gordon and McCann (2005)	The transmission of tacit knowledge at local level is much less important than commonly assumed
Lubinski (2003)	The advantages of agglomeration are weak, and his empirical research neither prove, nor disprove, the theory
Turok (2004)	It is necessary a wider perspective, at level of cities and regions
Clark, Palaska, Tracey, Tsampra (2004)	National strategies and sector level conditions shape the response of small firms to globalization. Development policies should not be limited to a cluster approach
Parr, Hewings, Sohn, Nazara (2002)	Development of infrastructure diminishes the advantages of agglomerations

YES

AUTHOR	MAIN ARGUMENT: the value of productive agglomerations is accepted and extended as follows
Keeble and Nachum (2002)	Advantages of agglomerations are supported by transnational links
Boschma and Weterings (2005)	Agglomeration in the high tech has positive influence; inter-firm co-operation seems not to enhance competitiveness
Angel (2002)	Large firms and firms located in major cities are the most likely to engage in co-operation for technology development
Scott (2002)	Continues his work on Hollywood
Scott and Storper (2003)	Propose the extension of their model on regional economies to developing countries

1.4.2 Competing approaches: Porter

While Neo regionalism developed, other approaches focusing on regional economies and firms' performances have emerged. Neo-regionalism is based on heterodox economics, it is included in the wide spectrum of critical theories, and its scholars position themselves as 'left wing' thinkers. Instead, Micheal Porter's 'clusters' are industrial districts analyzed with a neo-classical understanding of the economy. This theoretical framework, together with the personal position of Dr. Porter – full professor at Harvard, and author of books with a direct and recognized influence in the circles of top managers (Porter: 1980) – allowed Porter's work to be translated into State-led clusters support policies (vom Hofe, Chen: 2006). In *The Competitive Advantage of Nations* (1990) Porter structures the analysis around the concept of 'success,' analyzed at three levels: national, sector, and economic institution. To achieve success, a country, a sector and an institution must achieve, and maintain overtime, a competitive advantage. Competitive advantage derivates from 'positioning' achieved through cost containment and differentiation. His approach derives from management theory and it emphasizes competition and rivalry instead of trust and co-operation. He introduces the concept of cluster noticing that successful companies are often concentrated in specific cities (Porter: 1990, p. 29). He explains success in terms of his diamond: competitiveness is represented like a diamond, which angles are demand, factor endowment, strategy and rivalry, and cluster. In his vision, an industry becomes internationally competitive because 1) the domestic market of its products is strong; 2) the factor endowment is good; 3) competitive pressure encourages excellence; 4) there are strong linkages between customers and suppliers, which in practice are often traceable within cities. This clustering of interconnected firms leads to an intensification of the exchange of information, but also rivalry among firms. Bars, restaurants, clubs and other spaces of social interactions increase communications among people employed in the same field. At the same time, space proximity among rival firms increases competition and innovation. In this model there is no space for inter-firm cooperation. Therefore, there is an important overlap between Neo-regionalism and Porter's view. However, the two approaches remain drastically distinct: the ideological cleavage is at the root of different paths of theory building, which is connected with the use of different methodologies. At the level of theory, Porter's approach builds on the classics of spatial economy (Von Tunen, Launhardt, Weber), on the quantitative revolution in geography (Czamanski: 1974) and Krugman's New Economic geography. By doing this, Porter positions his work in the vein of positive science. As for methodology, there is a much wider use of quantitative methods and statistical analyses than in Neo-regionalism. This ideological, theoretical and methodological split reflects in the scarce acknowledgment of neo-regional work in Porter's citations and in the literature reviews, notwithstanding both lines of scholarship focus on the clustering of industries.

1.5.2 Competing approaches: GVC

In the 2000s there have been reciprocal influences between Neo-regionalism and Global Value Chain (GVC). GVC is very different from Neo-regionalism: it uses the firm as unit of analysis, instead of the region; it focuses on the global economy instead on regional performances. GVC literature started with the 1994 seminal work by Gari Gereffi ('The Organization of Buyer-Driven Global Commodity Chains: How US Retailers Shape Global Production Abroad' in Gereffi and Korzeniewicz (eds.) *Commodity Chains in Global Capitalism*, Praeger, Westport, 1994). In those years, the issue at stake was to find analytical tools to analyze economic globalization. Gereffi addressed the issue using the kind of analysis already made by firms – the commodity chain, i.e. all the processes and actors that lead the raw material to be transformed into a final product and sold to the market. First, this allowed collecting data directly from the firms. This approach has an advantage over the use of official statistical data: these data are collected by State institutions; therefore, they are very accurate when they analyze national economies, but they are weaker in transnational analyses. Second, by analyzing one value chain at a time, the global economy is divided into manageable units.

In his work, Gereffi extended the commodity chain analysis by noticing that a) enhanced co-ordination through information technology allows to break the processes of the chain in smaller units, and re-locate them in distant areas, and b) global retailers (like Wal Mart) were taking an increasingly active role in leading their suppliers along the chain to improve their products, contain prices, and co-ordinate more efficiently in order to shorten the processes of production. Basically, what Gereffi discovered was a new kind of post-Fordist vertical integration. In line with the already mentioned work by Harrison (1997), Gereffi's analysis shows that large firms have become capable of lean production, achieved through the co-ordination of several independent producers in their value chains.

Neo-regionalism and GVC have several common features. Both theories are concerned with upgrading of firms, innovation, flexibility, generation of profit. In these theories, innovation and upgrading is produced and circulated through networks. However, Neo-regionalism considers a blend of co-operation and competition in informal networks as the source of innovation, while In GVC, vertical relations and co-ordination from the leader of the chain is the source of upgrading. There are also important complementarities between the two theories. Particularly, neo-regionalism leaves out the issue of power among the actors involved, and is still weak as a tool to analyze the relations external to the region, while GVC can help in accounting for external relations and power issues. GVC doesn't consider institutional arrangements at local level.

It is because of these complementarities that the two theories have been compared and used together by Humphrey and Schmitz (2002) Bair and Gereffi (2004), Schmitz and Knorriga (*Development Studies* 37 (2), 177-205) and Smith (2003). The Bair and Gereffi paper finds that GVC works better than Industrial Districts to account for the developments of the Torreon (Mexico) jeans industry. Smith uses Actor Network Theory to analyze fluxes of power through the productive networks that link Slovak producers with their Western clients and local suppliers. He challenges the contrasting assumptions of the two theories - innovation and upgrading originating within the district vs. the vertical relations within the chain. Instead, in Smith's work innovation and upgrading depend upon relations among actors, which can be either the kind of informal relations described in the neo-regionalist literature, or the more formal relations described in GVC, or both. Smith focuses on the asymmetry of power among the actors involved in these relationships, especially from the point of view of the consequences on the paths of innovation and industrial upgrading.

1.5 The evolution of the Italian schools in the 2000s: the debate over the internationalization of Italian industrial districts

Thanks to the mechanisms of intellectual co-operation described in the previous sections, by the 2000s, some of the Italian scholars working on Industrial Districts were part and parcel of the debates of the Anglo-American academia. Particularly, Roberta Rabellotti

(2001 and 205) and a group of scholars connected with the Tedis Center at Venice International University (http://www2.univiu.org/tedis/index_2.htm) have been working on the same line of research as Humphrey and Schmitz (2002), Bair and Gereffi (2004), Schmitz and Knorriga (*Development Studies* 37 (2), 177-205) and Smith (2003). These scholars developed new approaches to join the research lines on industrial districts and global value chains.

Real world changes influenced this conceptual shift in the research on Italian industrial districts. Particularly, to respond to the increased competitive pressure in the global economy, some of the Italian districts, especially in the North East of Italy (ICE: 2006) have increased their degree of internationalization. Rabellotti (2001) analyzed the inclusion of the small firms in the Brenta footwear district in the global value chains of large multi-nationals. At the same time foreign investments from Italian districts grew significantly since the 1990s. This process started in the mid 1980s, later than the other EU countries. As Graziani (1997) pointed out, the efficiency of industrial districts was among the reasons of this delay. By the mid-late 1980s, new challenges appeared, because “the international market began to show signs of stagnation… domestic demand started to flatten out… On the supply side, price competitiveness became more stringent… At domestic level, the concentration level… was rapidly increasing” (Graziani: 1997) These factors led Italian firms to begin to relocate abroad, first in form of sub contracting, then pursuing acquisitions in the most sophisticated markets, “showing the fastest rate of increase [in outsourcing] among the [EU] countries (ibid.).

By the late 1990s and early 2000s, Italian scholars began to pay attention to this growing phenomenon of outsourcing from small and medium enterprises. Italian scholars considered the very structure of the industrial districts to be an obstacle to outsourcing, the cause of at least a decade delay in the process with respect to Germany: “[Until the mid 1980s] subcontracting was limited exclusively within national boundaries. The emergence and efficiency of this strategy can be attributed to the following features: the structure of Italian “industrial districts;” the large number of small, family-run firms; the shelter from foreign competition provided by the fragmented retail network in the national market; the focus of Italian producers on high fashion, quality and value-added content; and high levels of technological innovation and productivity among Italian producers” (Graziani, 2004).

Italian scholars have investigated these economic pressures from changing patterns in demand on the international and local markets, growing price competition, and the rise of large distributors in the internal market (ibid.) leading Italian firms to outsource in the 1990s. Jones and Kierzowski summarize those reasons by stating that “International fragmentation of production (defined as a production process spread over production sites located in different countries) will replace an integrated technology (where all production segments take place within the same location) if this allows producers to take advantage of differences in technologies and factor prices among countries, thereby obtaining a reduction in costs by setting up an international production network” (Jones and Kierzkowski: 2000).

EU customs and trade policies have been of central importance in stimulating industrial outsourcing to Eastern Europe, particularly the customs arrangement known as Outward Processing Trade (OPT) (Smith, Pickles, and Begg 2003). As Sdogati, Baldoni and Tajoli pointed out, OPT is “nothing other than international shipments for the purpose of processing abroad and consequent re-import. Goods re-imported after processing abroad are subject to custom treatment particularly advantageous relative to final import.” (Baldoni, Sdogati, Tajoli: 2000).

In this context, the use of GVC side by side with Industrial Districts approaches allowed Rabellotti and the Tedis group to analyze the impact of globalization on their districts, and the consequent re-organization of firms and internationalization (See: Rabellotti: 2004; Di Maria and Micelli: 2006; Corò and Volpe: 2006 Corò and Micelli: 2006 Chiarvesio and Micelli: 2006 Chiarvesio, Di Maria and Micelli: 2006(1) Chiarvesio, Di Maria and Micelli: 2006(2)). The main argument of this ‘Venice school’[6] is that – under competitive pressure and as indirect consequence of the inclusion in global value chains (esp. Rabellotti: 2004) district’s firm are ‘stretching out’ their value chains establishing contracting relations and/or FDI with locations overseas, among which Eastern Europe plays a key role. This phenomenon is leading to a new kind of internationalization, in which Italian firms are contributing to the re-working of local conditions – in order to recreate district-like interfirm and firm-institutions relations abroad (‘district to district [D2D]’ relations mentioned by Corò and Volpe: 2006) and to turn the Italian districts in managing hubs of international networks (Rullani: 2002).

The main problem of this approach is that the units of analysis in GVC and Industrial Districts do not coincide. Italian authors addressed this issue by shifting the unit of analysis from the region to the firm. Especially in Di Maria and Micelli (2006) the argument is that leading firms in the district turn themselves into ‘open networks’ of international contracting; as consequence of this, they re-work also the contracting relations within the district. However, this ‘turn to the firm’ has a price, i.e. it becomes more difficult to account for the

[6] The definition is mine. These are scholars working in North eastern Italy, the area with the highest level of outsourcing and FDI towards Eastern Europe in the universities of Padova and Venice.

impact of local institutions (both in Italy and overseas), conventions and tacit knowledge as in the traditional industrial districts literature.

This discussion has both theoretical and policy implications. At policy level, the internationalization of firms is seen as one of the strategies for resolving the crisis of the Italian economy and the stagnant GDP (ANSA: 2006). At theoretical level, the ways in which the Italian model is reproduced by firms relocating abroad is investigated to understand the ways in which industrial districts are becoming nodes of broader international networks. Particularly, this topic has been a matter of debate between Enzo Rullani (2002) and Charles Sabel (2004). Rullani finds a response to the current crisis of Italian industrial districts in "Re-localizing the circuits of propagation [of economic development], transforming the local clusters in nodes of a wider, international system… [and] the localized social capital in a more complex and articulated network of relations. … The propagation of development will happen more rapidly along those channels that will be able to reproduce – in other places – the same, or at a least similar, environment that small entrepreneurs from the clusters know today" (Rullani: 2002; translation: C. Sellar).

This last point raised Charles Sabel's objection. He articulated his critique around the ways in which, firms located in distant areas co-ordinate production in a Post-Fordist regime. According to Langlois (2002) co-ordination is achieved through growing standardization and the transformation of products in modular systems. Lamoreaux, Raff and Temin (2003) instead highlighted the social linkages among companies' representatives, and long term relations as basis for co-operation. However, according to Sabel, both approaches are weak in addressing the issue of constant innovation, which is the essential key of success in the new economy. The answer he gave to this problem is pragmatic co-operation, in which companies belonging to the same value chain are engaged in practices of iterated co-design of products and technologies. As consequence of this, he opposed Rullani's view of expansion of the industrial districts model as a view of reciprocal adaptation.

1.6 Conclusions

Since the 1980s, Anglo-American geography and Italian 'Industrial Districts' schools have developed close contacts and intellectual exchanges. These exchanges took three forms: first, the Italian systems of small firms became object of analysis in the Anglo-American neo-regionalism; second, there were reciprocal influences in the theoretical developments of the two schools; third, interpersonal connections and common intellectual interests supported Italian scholars in publishing in the Anglo-American scientific journals. A theoretical common ground and similar research interests allowed this co-operation. First, both schools derived their understanding of the economy from heterodox economics; especially the work of Alfred Marshall constitutes a bridge between the two schools. Second, both schools focused on systems of small firms as carrier of innovation, competitiveness and industrial upgrading. In order to analyze these systems, they both used the region, or district, as unit of economic analysis.

At the same time, there are important theoretical differences between the two schools. Neo-regionalism attempted to develop a theory of regional development capable of explaining the post-Fordist mode of production. They applied the concept of 'region' and 'regional economy' to a broad range of geographical, historical and economic conditions. This led to theoretical and methodological problems, the most important being the lack of precise definitions of the concepts of 'region' and 'regional economy' and the difficulty in developing comparative case studies. Instead, the Italian approaches have a more limited focus on some local areas in Italy. However, the Italian schools also face some theoretical problems, especially as far the quantitative models developed to identify the industrial districts and the still fragmented organization of the theory.

These differences in theory depend upon the different phenomena investigated: the Anglo American scholars in the 1980s and 1990s were mostly concerned with a world-wide economic crisis, which was showing the inefficiencies of production systems based on large, vertically integrated firms. Piore and Sabel and, later, Scott and Storper, found that vertically disintegrated systems of small firms could represent a way out of the crisis. Instead, Italians were concerned with changes in the Italian economy that did not fit the predictions of the commonly used economic models. They realized that the traditional distinction between rich and industrialized North and agricultural and underdeveloped South of Italy was not working anymore; instead, a very dynamic new system was emerging on the East Coast of Italy, which was based on small firms. The literature on Industrial Districts started as an explanatory model for this new phenomenon.

In the 2000s changes in the world economy and new conceptual developments led the evolution of the two schools of thought. Particularly, large firms have adapted themselves to the increased competitive pressure of globalization by becoming lean (Harrison) and competing with small firms as far flexibility. Therefore, Neo-regionalism has shifted from focusing on small firms to regional performances as a whole. At the same time, a new approach – GVC – provided an alternative explanation of the processes of industrial upgrading: instead of the processes of informal transmission of knowledge in the district, GVC focuses on inter-firm relations along the value chains.

Neo-regionalism and GVC approaches have been used together in order to a) provide a more nuanced explanation of the transmissions of knowledge and industrial upgrading among firms and b) analyze the ways in which regional economies are related to the broader national and global economy. This last development has been very influential on the Italian schools. Especially in the North East of Italy, increasing productive de-localization and the inclusion of districts into the value chains of global buyers have transformed the districts. From rather self-contained productive systems, they have turned into nodes in international systems of production (Rullani). In order to analyze this new phenomenon, some Italian scholars (Corò, Di Maria, Micelli, and Volpe) used GVC approaches to build an explanatory model for these transformations. In so doing, they shifted the unit of analysis from the region to the firm, focusing on the leader firms in the districts (open networks), which are the main agents of internationalization of the districts and at the same time are re-working the contracting relations within their home districts.

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Chapter 2
Towards a local model for the internationalization of Italian firms in Eastern Europe

2.1 Outline

The previous chapter has shown that the most recent Italian (Rabellotti: 2004; Di Maria and Micelli: 2006; Corò and Volpe: 2006 Corò and Micelli: 2006 Chiarvesio and Micelli: 2006 Chiarvesio, Di Maria and Micelli: 2006(1) Chiarvesio, Di Maria and Micelli: 2006(2)) and Anglo-American (Dunford: 2006; Dunford and Greco: 2006) literatures on Italian industrial districts, instead of considering the 'region' as unit of analysis have shifted to a firm-based approach. This approach, that introduces Global Value Chains analysis in the scholarship on industrial districts, has several advantages. First, it analyses the changes in inter-firm relations both inside and outside the district as consequence of the growing internationalization of production (Micelli: 2006). Second, it shows that districts are "just one part of an interdependent division of labor and an inter-dependent territorial system" (Dunford: 2006, p. 29).

However, the previous chapter has also shown that this new approach is weaker than the traditional Industrial Districts literature in addressing the role of local institutions and conventions, and the mechanisms of transmission of tacit knowledge in the overall performances of the districts. More in detail, this chapter speaks to what Micheal Dunford called the 'Marshall second argument,' i.e. that districts are not a purely economic phenomenon, but are centered on the interactions of economic and social systems (Dunford:

2006, p. 27). Becattini built largely on this concept, considering districts as 'communities of firms and people.' The Florentine school, and especially Gabi Dei Ottati and Marco Bellandi (see Becattini et al. 2003) developed this concept, analyzing the impact of social norms, close-knit groups and credit policies and political subcultures on business transactions. This chapter explores the possibility to include these 'institutional dimensions' into the new firm-based approaches. The analysis focuses on Italian textile and clothing firms establishing economic relations in Eastern Europe. Through subcontracting relations, joint ventures, foreign direct investments, Italian firms are inserting themselves into new communities, and must adapt to new social, cultural, political and institutional conditions. At the same time, by providing a sometimes relevant share of employment, and by engaging the local institutions in these communities (see especially Chapter 3 and 6 for case studies in Romania, Slovakia and Ukraine) they are an agent of post-Socialist change. What kind of changes do Italian firms bring to local communities? How are the transformation of firms and the transformation of institutions co-related? How can GVC analysis contribute to the understanding of these phenomena?

In order to answer these research questions, a three stages argument is developed. First, the units of analysis are discussed. In order to understand the reciprocal influences between Italian firms and local communities, three relevant kinds of actors are identified: the firms themselves, the local institutions, and banks and services. Second, the international connections of these actors are considered. This entails a description of the textile, clothing, banking and services, value chains; it also entails a description of the international connections of those local institutions in Eastern Europe are developing thanks to the European Union and its grant schemes (Structural funds, the now expired PHARE program and others). Third, the interconnections between local institutions, banks and services and Italian firms are considered.

2.2 Units of analysis

2.2.1 Firms

The most important unit of analysis in this dissertation is the ‘Italian firm abroad,’ operating in the textile and clothing sector. This category captures the fact that Italian firms overseas “extend beyond arm-length trade relationships, including both ‘light’ involvement through agreements and partnerships that do not include capital risk and ‘deeper’ involvement based on foreign direct investments in joint ventures and Italian-owned firms” (Mariotti and Mutinelli: 2001, translation C. Sellar). These different forms of economic involvement are summarized and categorized in Table 2.1 and 2.2. This categorization considers two forms of involvement overseas: first, the investments and, second, the deployment of personnel from Italy overseas. Investments can vary from close to zero (in arm length trade relations) to 100% ownership of the foreign company. However, the investment never reaches zero: even in the case of ‘light’ involvement, some resources (time and financial) must be spent to find the appropriate contractor, visit them and their production facilities in order to assess their suitability for the job. The next stage is partial ownership, in the case of 50/50 joint ventures in which Italian and local investors share the responsibility of managing the local company. The following is a situation of heavy control, either with 100% Italian ownership or small amount of shares divided among local people who helped set up the company. As for personnel, the presence may vary from occasional support by a technician (in the apparel industry, it is common whenever a new product is being produced) to regular trips by the entrepreneur or a director, or to the permanent presence of the Italian entrepreneur (entrepreneurial migration) or the director overseas. In some cases, the factory is managed by a local director with extensive experience in Italy and strong trust relations with the Italian entrepreneur.

Table 2.1 combines the two categories to account for the intensity of Italian involvement in the local Eastern European firm. The first category, characterized by investments close to zero and occasional visits by technicians, is the traditional subcontracting. This is the way in which Italian textile and clothing companies began to move abroad in the 1990s (Interview EDAS, entrepreneur: 09-26-05; Interview Mario Boselli, president of the Italian Chamber of Fashion: 10-10-06), and, according to Corò and Volpe (2006) it is still the preferred way of internationalization for most of the financially weak SMEs. Besides this, the fieldwork research detected stronger forms of subcontracting: it is the case in which Italian firms set up a foreign investment in the form of a productive platform, which co-ordinates the work of several local producers. In these cases, the local producers are more closely controlled, thanks to geographical proximity. A further form of involvement of Italian manufacturers abroad is the establishment of joint ventures with local producers. This is often the case of firms willing to achieve stronger control on the productive process with a fairly low amount of investments. In these cases, the most common pattern is that the company is managed by the local partner, with the Italians providing technology, organization, and market. This partnership can be weak or strong, depending on the amount of control that the Italian partner wants to exercise on the productive process. There is an obvious temporal component in this distinction: newly established joint ventures are usually followed closely by the Italian partner; if the JV is successful and lasts overtime the visits tend to become more infrequent. The following excerpt of the interview with Ms. Maria Kushilka, Ukrainian entrepreneur in an Italian-Ukrainian JV active since 1998 shows how the Italian involvement was connected with the start up phase and to major changes in the company:

> We kept our structure and personnel. In the beginning, we had one Italian manager - one of the brothers owning the company; he is director of production in Italy - to help the start up. He managed the introduction of new machines and the change in the production process. We didn't change the organization of personnel. In the first six months we had one Italian couple working here. They were technicians helping us to improve the quality. In the first few years we only sew; five years ago we introduced the ironing and the packaging. At that moment we had again Italian technicians helping to start the new department (Interview Ternotex, entrepreneur: 07-14-2006).

The most intensive involvement is the foreign direct investment. Legally, it consists mostly in the establishment of a local company (given the small to medium size of many Italian firms, the favorite form is the limited liability company) with Italian capital. In the fieldwork, cases were detected in which the control of the Italian ownership on the internal organization of the factory was very limited. However, this was limited to 'third wave' investments: i.e. Italian owned firms already established in Slovakia made an additional investment further East in the Ukraine. In this case, personal connections of their Slovak partners or directors in Ukraine were very important in establishing the investment, which reflects in a weaker Italian control on the company. A more widespread case is the regular visit of the Italian entrepreneur and/or director in the foreign plant. This is the case of family businesses – a model in which family based ownership and management coincide - which maintain a base in Italy and the entrepreneur shares his or her time between Italy and the location in Eastern Europe. In this case, an important factor in the success of the company is the presence of a local director having a personal relation of trust with the Italian entrepreneur. These are truly international people, from the local area, but with many years of study and working experiences in Italy, that allow them to be mediators between the Italian ownership and the local context. The strongest case of control is the permanent case of the Italian entrepreneur or director in the foreign plant. This is either the case of financially strong companies, that can afford a director permanently residing abroad, or case of 'entrepreneurial migration' in which either one of the shareholders of an Italian firm has moved abroad to work in the foreign affiliate, or a physical Italian person moved abroad to establish a new company – as often the case of Benetton's subcontractors, who has been pushed to re-locate abroad to follow Benetton's investments (Interview EDAS - Italian consultancy in Slovakia: 09-26-05).

Table 2.1: Involvement of Italian firms abroad

		FLUXES OF PEOPLE		
		Occasional visits by technicians	**Regular visit by entrepreneur/director**	**Permanent presence of Italian entrepreneur or director**
FLUXES OF CAPITAL	**Arm length trade relations, close to zero**	Subcontracting	Strong subcontracting	no
	50-50 joint venture	Weak partnership	Strong partnership	no
	100% (or close) Italian ownership	Weak ownership. Often the case in 'third wave' investments, from Eastern Europe further East	Medium control ownership. Key distinction: presence or absence of a local director with strong Italian connections	Strong ownership. Key distinction: presence or absence of local stakeholders

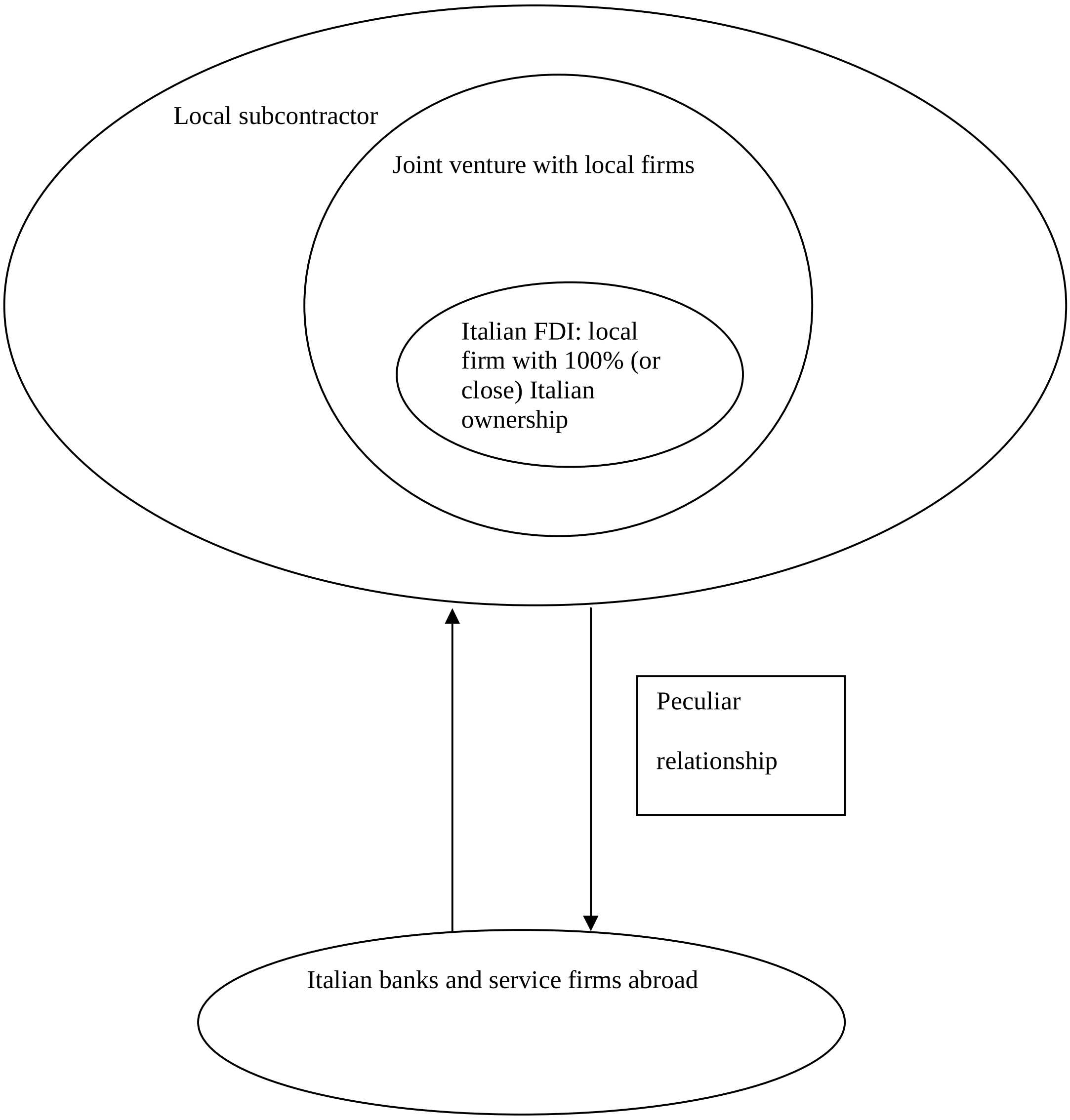
Table 2.2 represents graphically these different forms of involvement of Italian firms abroad. the small number (according to Corò and Volpe: 2006) of firms with 100% Italian ownership lays at the heart of the category, as the most intensive capital and human resources deployment. Next to it there are the joint ventures, in which capital and human resources are jointly deployed by Italians and local partners. The last category concerns subcontractors. At this level, the category becomes porous, since subcontractors are a) more deeply included in the local environment and b) they may work for clients other than Italian companies, therefore their degree of connection with Italy may be quite low.

Italian banks and service firms abroad are foreign direct investments, in which the parent firm in Italy owns 100% (or close to 100%) of the subsidiary firm abroad. Banks and service firms have a peculiar relationship with Italian manufacturers abroad. By providing Italian speaking financial and non financial services to the manufacturing firms, they provide an interface between the Italian firms and the local institutions and – broadly speaking – environment. Consultancies provide services such as payroll, information about the local fiscal, labor and other norms, but also less tangible 'cultural' services. For example, Dr. Vito Bovoli, owned of EDAS, an Italian consulting firm in Slovakia, describes his job as follows:

> We provide also 'cultural' support, providing a bridge between Italian and local entrepreneurial cultures. With respect to culture, EDAS helps to 'organize human resources in a correct way,' helping entrepreneurs to understand norms and rules of the organization of labor force. First of all, they insist on the concepts of 'listening' the inputs coming from the local people. Second, they provide detailed information on norms and customs: for example, in Slovakia contracts of employment specify in detail employees' duties, while in Italy they tend to be much less detailed. Then they let them understand that the fact that Slovakia is less rich than Italy does not mean that there are no rules (health and security measures). (Interview EDAS, entrepreneur: 09-26-05)

Providing these ‘cultural services,’ they contribute to the overall governance of Italian entrepreneurial activity in Eastern Europe. The ways in which Italian banks, services and manufacturers are inter-related will be discussed in the next chapter.

Table 2.2: Italian firms abroad: categorization according to ownership



2.2.2 Institutions

In Eastern Europe, Italian firms are affected by a wide range of institutional actors. Once the investment is established, local mayors and sometimes local schools establish relations with the Italian factory, as shown in these interviews with Italian clothing firms in Slovakia and Ukraine:

> Q.: You said there is a textile school.
> A.: Yes. At the moment, they teach only sewing. In summer, they used to send us ten or fifteen students for an internship, and we often hired them after they graduated. However the youngest generation, the nineteen or twenty years old do not have the aim of working in factories anymore; they emigrate more, they go to the UK, Switzerland, and Ireland. (Interview Entrepreneur, Italian firm in Slovakia, 07-14-06).
>
> When we had problems in constituting the company, we involved local politicians in the process. We were lucky to meet people like the mayor. He didn't ask any personal favor, because he understands the importance of foreign investments for the town's economy. He gave us political support; he introduced us to the right interlocutors at regional level. He was very important for us. With people like him we keep having good relationships; with other people we broke the relationship. (Interview Dr. Conte, Supervisor, Italian firm in Ukraine: 07-14-06).

At the national level, the largest Italian firms can have access to the support schemes to foreign investments that many of the governments have established throughout Eastern Europe. Large investments give them direct access to the ministries, which usually smaller firms do not have. One example of this is the Miroglio Group, the largest Italian textile investment in Bulgaria:

> We have a fifth plant in the city of Iambol, which is in the making now. Last week we were appointed with a certificate of first class investment from the ministry of economy. For the earlier investments there wasn't this law yet (it was approved last year in July), but we are benefiting now because the investment is still in the making. [To obtain this certificate] we went directly to the Ministry of Economy. This is a 40 millions of Euros investment, which is a little more than the 70 millions of Leva that you need to obtain that certificate (Interview country manager, Miroglio Bulgaria: 05-17-06).

This ‘certificate’ entails significant support from the Bulgarian State, which takes the obligation of building infrastructures customized to the needs of the investor up to the border of the plot of land where the investment is located. However, investments smaller than 10 millions of Leva (USD 6.8 millions) are not entitled to special support from the Bulgarian State; therefore, only medium and large groups can have it (Interview State Expert, Investbulgaria Agency, Ministry of the Economy and Energy of Bulgaria: 10-27-05). Besides this, national level institutions have a direct impact on firms through norms and laws, which affect firms on important issues such as fiscal pressure, wage levels, regulation of the trade unions activities, and others.

Besides local and national institutions of the Eastern European states, the ‘Italian system’ as a whole is responsible for the creation of new institutional spaces abroad. Particularly, Italian embassies, the Institute for Foreign Trade, bi-national chambers of commerce, associations of Italian entrepreneurs abroad, local offices of Italian regional governments work, albeit with an uneven degree of cohesiveness and influence, towards the stabilization of the Italian presence abroad. Finally, the European Union requires the new member states of Eastern Europe to include EU norms and standard (collectively named *acquis communitaire*) in their legislation. The EU also provides funds through its grant schemes and programs (the most famous are Structural Funds for the member states, and the now expired PHARE program for the accession states) to support new members’ adoption of the acqis, impacting the institutional environment in which Italian firms operate in ways that will be discussed in the next section.

2.3 International connections of firms and institutions: textile, clothing, banking and services value chains and 'transnational institutional chains'

2.3.1 Textile and clothing value chains

The textile and clothing value chains have been thoroughly discussed by Gari Gereffi and the GVC group (see www.globalvaluechains.org for a list of the group's publications). Gereffi (1994), (1999) has focused on the role of leading firms in the apparel sector in promoting the upgrading of some regional concentrations of producers. From this initial work, a consistent body of research analyzed the advantages and the disadvantages that apparel producers and regional economies face in being included in the value chains of global buyers. Tokatli (2007) and Smith (2003) analyzed the power relations along the apparel value chain; Cammet (2006) focused on the role of global buyers in promoting regional concentrations of apparel manufacturers. Dolan and Tewari (2001) discussed the processes of upgrading in the textile and food value chains in India and Kenya. Several papers (Schmitz: 2006), (Schmitz and Knorriga: no date), (Palpacuer and Poissonnier: 2003) focus on the constraints that the inclusion in the apparel value chains impose on manufacturers. Particularly, these papers present several case studies in which the global buyers support product and process upgrading (i.e. the improvement of the quality and timing of production), but hinder functional upgrading, and especially the development of own brand manufacturing. A large set of papers investigated the connection between the inclusion of apparel industry in global value chains and economic growth in developing countries (Bair and Peters: 2006, Giuliani et al.: 2005, Palpacuer et al.: 2005, to quote the more recent papers).

All these papers have in common the focus on the action of global buyers, large multi-nationals. The most famous US based are "giant cost-driven discount chains (Wal-Mart, Kmart, or Target), upscale branded marketers (Liz Claiborne, Tommy Hilfiger, Nautica), apparel specialty stores (The Limited, The Gap), and burgeoning private label programs among mass merchandise retailers (JC Penney, Sears)" (Gereffi: 1999, p. 40). Among European companies the most important are the Spanish Inditex, (owner of brand names as Zara and others), the Swedish H&M, the German CMD, the British Next, Max and Spencer (which lost market shares in recent years); among Italian companies, Benetton and Vestebene (the apparel division of the Miroglio Group) are the most important (Interview country manager, Miroglio Bulgaria: 05-17-06). Instead, Dunford (2006) argued that the Italian textile and clothing industry, together with leather, cosmetics, accessories and the production of industrial equipment (sewing machines, cutting tools, etc), is shaped "by a range of services… and the structure of the distribution system" (Dunford: 2006, p. 29). In so doing, he extended the analysis of the value chain to include the articulation between production, distribution and supporting services.

In Dunford's view, service firms located in Milan (including research, design, showrooms, magazine publishing, organization of fashion fairs) co-ordinate a very diverse group of producers, ranging from large groups (as Miroglio) to medium and small enterprises clustered in the industrial districts. The competitiveness of this system as for prices has been maintained over the years through subsequent waves of de-localization of production. Analyzing the geography of employment trends in the textile and clothing sector, Dunford shows that the manufacturing activity shifted from the North West of Italy towards the industrial districts in the North East and East coast of Italy in two decades from 1971 to 1991 (see Dunford: 2006, p. 38 for a map of these trends). After 1991 the general trend of decrease of textile and clothing employment in the whole Italy is matched with a new wave of de-localization to Eastern Europe.

One of the consequences of this particular system is that the de-localization concerned the whole range of producers, from the large to the small. Qualitative data from the interviews collected in this fieldwork suggests that large firms had a leading role in this process, attracting their own subcontractors overseas. Dr. Vito Bovoli, owner of a consultant firm that has supported the internationalization of Italian firms in Slovakia since 1992, describes this process as follows:

> In the years from 1990 to 1998-1999 Italian textile producers de-localized to Slovakia. In doing this, [large] producers pushed their sub-contractors to move abroad to contain costs. By the year 2000 the subcontractors were pushed again, to move to cheaper labor countries, Romania, Bulgaria, and Ukraine.
> The textile and clothing businesses who remained in Slovakia are the one who adopted a strategy of internationalization: they made heavy investments, brought technology with a long term strategy aimed at market penetration, based on a quick co-ordination between retailer and producer. Terzisti instead did not have the capacity of investing heavily – usually their investment is limited to renting a space and bringing sewing machines from Italy, so they remained anchored to the logic of price containment. (Interview EDAS, entrepreneur: 09-26-05).

This variety of firms was confirmed in this fieldwork research. It detected cases of entrepreneurial migration (i.e. entrepreneurs establishing firms abroad without connection to a parent firm in Italy) in the case of Benetton's subcontractors, service firms (dyeing, embroidery works) and platforms (i.e. firms co-coordinating the work of several subcontractors). Among foreign investments, there are factories owned by very large groups (as Miroglio), but also medium sized firms, working partly as own brand manufacturers, partly as subcontractors for larger companies.

2.3.2 Banks and services value chains

One of the consequences of having large numbers of small firms moving overseas is the emergence of a demand for basic services – banking, accounting, and start up services. Large firms moving overseas can be supported by their own legal, accounting and financial experts, and are in conditions to negotiate the investment directly with the national governments. Small firms often cannot afford the necessary investment in human resources (interview general secretary of the Italian Chamber of Commerce in Bulgaria: 10-31-05) . Partly to respond to these needs, partly following a broader market logic – analyzed in chapter 3 - Italian banks and manufacturers followed the first waves of Italian manufacturers in the 1990s.

The most important difference between these value chains and those enacted by manufacturers is the effort to be present, with as much as possible uniform services, in all countries of the area. It is through the action of banks and service firms, plus, of course Italian institutions abroad (embassy, Institute for Foreign Commerce) that a network of support for the activity of manufacturers has been put in place. The peculiarities of this network will be discussed in the following chapters; here it is important to notice that, unlike firms that tend to establish bi-lateral relations between Italy and one or more locations in the area, banks and service firms are making an effort to act multi-laterally across Eastern Europe.

Particularly, Chapter 3 will analyze the internationalization of a major Italian banking group – Unicredit – and of a consortium of service firms – IC & Partners. In so doing, the chapter will argue that the internationalization of Italian manufacturers followed a progressive model in which light forms of involvement overseas (namely, subcontracting relations) were followed over time by heavier involvement through foreign direct investments. This model has a temporal and spatial component: it started in the countries closest to Italy in the early 1990s (represented by Slovakia and Romania in this research), and then it was re-produced in the late 1990s-early 2000s while Italian firms moved further East. I will argue that banks and services are an essential component of the stabilization of Italian firms overseas: as soon as Italians began to establish foreign direct investments, banks and services followed them and helped manufacturers to interface with the local institutions and legislation. Also I will argue that Italian manufacturers, services and banks establish a peculiar form of interaction, based on 'cultural' and language services, which is different from other groups of foreign firms in Eastern Europe.

2.3.3 towards 'transnational institutional chains?'

In establishing themselves in Eastern Europe, Italian firms must connect with local institutions that are going through a process of deep change, which is part of the broader trend of post-socialist transformation. This dissertation argues that the transformation of Eastern European institutions, especially State bureaucracies at national, regional and local level in the new members of the EU, is heavily influenced by forms of co-operation with Western European institutions. More precisely, I argue that these forms of co-operation are structurally not very different from a value chain.

International donors (World bank, IMF, the EU, USAID) have accepted since the 1990s the findings of neo-liberal scholars (see, for example, Lipton and Sachs: 1992 and Aslund: 2002), according to which a successful transition from planned to market economy involves macroeconomic stability and rule of law – including both stable and well defined legislation, and capacity of enforcement - (EBRD *Annual Reports* series, and particularly EBRD "Operational Environment" in *Annual Report 1997*). Since the early 1990s, a significant effort from international donors has promoted the transformation of Eastern European institutions, with the joint objective of promoting 'democracy' and 'market economy.' For example, the US government intervened in the process with Support for East European Democracy (SEED) act (http://www.usaid.gov/policy/budget/cbj2007/an/seed.html); private donors as the Soros Foundation have a wide range of programs in the region (http://www.soros.org/initiatives/regions/south-eastern_europe). However, the enlargement of the European Union in the area has brought the largest financial contribution to the transformation of institutions in the area. The EU has several programs to support institutions in Eastern Europe: the Structural Funds, dedicated to EU members; the now expired PHARE Program, dedicated to accession countries; ISPA "has been funding transport and environmental schemes … It provides direct financing for environmental projects to help apply directives that call for heavy investment, and for transport projects" (EU electronic document) and SAPARD (for the support of agriculture). PHARE, active from 1989, had a budget of Euros 1.6 billion per year, of which 30% were dedicated to institutional transformation and 70% for investment support (see The European Commission's Information Centre on Enlargement: 2003); ISPA has a budget of Euros 1 billion per year, SAPARD Euros 0.5 billion. As a comparison, USAID budget for Eastern Europe in recent years ranged from USD 440 millions in 2004 to USD 270 millions in 2007 (USAID).

Especially the funds from the European Union are allocated through competitive grants, which funds projects that privilege the co-operation between Eastern European and Western European institutional partners. Detailed case studies on the ways in which these projects have transformed city level institutions in Timisoara, Romania and nation level policies in Bulgaria will be discussed in chapter 4 and 5. These projects establish connections between institutions that have several points in common with the value chains in the industry. The GVC literature has pointed out that leading firms in the chain support the upgrading of their suppliers and/or clients by providing them access to new technology and/or organizational skills (Gereffi: 1994, Bair and Gereffi: 2001, Schmitz: 1999). Similarly, through the EU funded projects, Western European institutions ‘transfer’ to their Eastern European partners a set of practices involving the adoption of new norms, organization, and training for State officials. The case study of the ‘Agency for Economic Development of Timis’ (ADETIM) discussed in Chapter 4 is a paradigmatic case of such transfer: the agency was initially funded by a German regional agency, which transferred to its Romanian partner its own organization, trained the officials and worked with them in implementing projects of economic development in the first few years of activity. Second, the GVC literature points out that global value chains are vertically disintegrated, and are characterized by uneven power relations between independent partners. In similar ways, EU projects bring together institutions belonging to different States and therefore independent from each other. As for power, the bureaucratic rules connected with the disbursement of funds introduce a mechanism of control on the execution of the projects. A high level State official of Bulgaria described the impact of this new kind of power relation on Bulgarian civil servants as follows:

> I worked in this region since 1998. In this period there have been two important changes in the attitude of the administration. First, they had to learn that whatever they do with public funds they have to follow the procedures, while in the old days the major used to have the final word on the use of public funds, which is not possible anymore, since there are strict procedures to get EU funds. Second, most of the regional authorities understood the need of having at least one person to manage EU projects. (Interview Head of the Directorate for Technical Co-operation and Management of Regional Plans and Programs, North Central Region, 11-07-05).

Chapter 5 will discuss one specific example of an EU funded project, 'Virtual Clustering Identification and Dissemination of Strategic Territorial Planning Best Practices for Certain Countries of Danubian and Southern Europe' (VICLI), carried on in 1999 and 2000 (VICLI, electronic document). In this project, a pool of Italian, Hungarian, Romanian and Bulgarian regional and national level authorities came together to identify "strategic territorial planning for clustering of productive activities set-up by small and medium enterprises in the industrial sector" (VICLI). Looking at the structure of the project, and at the ways in which it was implemented, the central role of consulting firms emerges. More precisely, in the VICLI case, the actual execution of the project was co-coordinated by the Italian public private partnership Informest (www.informest.it), while local consultancies and/or think tanks carried on the project in Hungary, Romania and Bulgaria. These firms are a) equipped with the necessary know how to both apply for and carry on projects; b) their members have a wealth of personal contacts both among the institutions in their own countries and similar organizations and institutions abroad and c) they hunt for new ideas to apply in the policy realm, with frequent excursions and world of research and academia.

Lovering (1999) was the first to reflect on the emergence of this new ‘service class’ of consultants, which he saw as the way in which corporate elites re-appropriated the new institutional spaces emerging from the weakening nation states and the rise of regions as prime political and economic actors (Lovering: 1999, pp 389-390). This view of ‘institutional chains’ adds to Lovering’s interpretation a transnational dimension: by co-coordinating the EU funded projects, consultancies are a key element of the EU led continental integration, supporting the construction of homogeneous institutions among the members of the EU. For example, the chairman of the Foundation for Entrepreneurship Development (FED) (www.fed-bg.org) among the oldest and best established think tanks in Bulgaria summarized the role of FED in contributing to the institutional changes in Bulgaria as follows:

> Nowadays the financing of the foundation comes for the 80-90% from our activity of consultants for EU projects. In the EU projects, usually the funds go to ministries, which distribute them to consultants, who organize teams for the implementation. In this framework, we contributed to establish many structures, and trained their personnel. (Interview Chairman of FED: 10-26-05).

2.4 Emerging hybrid spaces in Eastern Europe

2.4.1 International connections of firms and institutions as carriers of tacit knowledge and shared world views

This section argues that the activity of ‘Italian firms abroad’ is part and parcel of a broader process, in which international connections re-shape bureaucracies, firms and their inter-relations. This happens both at national and local level throughout Eastern Europe. The outcome of this process is the establishment of hybrid spaces, in which imported technology and management style (at firms level) and norms and organizations (in the public sector) mix with the local conditions.

One of the ways in which these changes are introduced is through the transmission of tacit knowledge. Within Italian firms abroad, the constant interactions of local managers, cadres and workers with Italian technicians/entrepreneurs/directors has both the function to transmit tacit knowledge through 'learning by doing' processes and to guarantee that the newly acquired notions are actually applied, without falling back in the old system once they leave. The Neo-regionalist literature considers untraded interdependencies based on social conventions developed through proximity at the root of the paths of technological development of regions. My argument here is that untraded interdependencies may also travel along the value chain, because the activity of contracting and investing often presupposes a thick set of face to face relations that favor the development of mutually understood codes. The following excerpt from the interview with Mr. Pandy, Slovak director of an Italian owned company gives an hint on how this process works:

> Q. What did it change at the level of innovation and management as a consequence of working with Italians?
> The most important change is that we got more modern machines. Then the organization was brought at an higher level.
> A. What does it mean 'higher level organization'?
> Comparing with communist times, now one worker can perform a task that before required two or three people. The productivity is three times higher.
> Q. How could you achieve this?
> A. In the first period of activity, there was an Italian [technician] constantly present here; he showed us how to work.
> Q. What did he do?
> A. He showed us personally that just one person can perform certain tasks. He had to do it, because we didn't believe it (interview Italian firm in Slovakia, local director, 07-21-2006).

However, this transmission of untraded interdependencies along the value chain requires a) thick interpersonal, non economic, relations, which are needed to understand the reciprocal conventions and b) an interplay of power relations within the company. Erszebeth Horvath, local partner in an Italian-Ukrainian JV, summarized as follows the engagement with the Italian shareholders:

> We and the Italians definitely have different mentalities. However, we worked to get closer: we studied each other languages and, as part of our JV agreement, we decided to talk every day to keep constant contacts. They come here to check the production. In the beginning they came every two months, then less and less, and last year they didn't come for eight months. We became friends. However, comparing with us, they are cheap. They do not raise the prices often, they make questions for every cent, and it is difficult to cover the expenses with what they pay (Interview Vistex, entrepreneur, 07-13-06)

In the case of Ms. Horvath's company, a process of breaking cultural barriers through constant interpersonal communication was formally established in the JV agreement. However, frequency of interaction alone is not sufficient to account for the traveling of untraded interdependencies along the chain. It is also important to consider the partners in the interactions and their role (and, more broadly, the power relations) in the local company. Italian firms are pressed between cost saving issues - and therefore they reduce the employment of Italian labor abroad to the bare minimum – and the necessity to get the work done according to their standards. The response to this problem depends on the degree of the company's commitment abroad. In the case of traditional subcontracting, the transmission of tacit knowledge may be limited to a few meetings between Italian technicians (or entrepreneurs directly) and local entrepreneurs. In cases of stronger involvement (strong subcontracting, JV, ownership) the usual way is to train closely some key figures within the local company, that can in turn re-transmit tacit knowledge to the rest of the company. This process varies in intensity according to the Italian commitment abroad: In case of the JV considered above, it consisted in working closely with the local partner abroad; in case of larger investments, an Italian entrepreneur or a director of production puts special care in training middle managers. The extreme case is represented by very large investments, like Miroglio in Bulgaria, in which more than one hundred people were brought to Italy for training, for periods ranging from two months (for workers) to one year (managers) (Interview Miroglio Bulgaria, country manager: 05-17-06). Although these training programs may be very different among each other, the basic goal is the same: to find a few trustworthy local persons who speak Italian, work with them to transmit tacit knowledge, and then assure they have a position in the local company that is the most suitable to transmit the knowledge to other employees.

The transmission of tacit knowledge, as any interpersonal relation, presupposes a shared world view, a set of assumptions shared by all the actors involved. This set of assumptions constitutes one further dimension of international co-operation. The basic assumption of Italian manufacturers going to Eastern Europe is that their own technology and organization is the best fit to produce high quality clothing and textiles. The extent to which this assumption is shared by the local partners and employees, and the ways in which it is adapted to the local conditions constitutes a delicate moment in the establishment of the Italian commitment overseas. The tension between the export of the 'Italian model' and the adaptation to the local environment is summarized by the Slovak director of an Italian-owned clothing company as follows:

> Those who wanted to work well in Slovakia had to adapt to the local conditions. However, the idea behind the investments is always to bring the Italian mentality and way of working in Slovakia. The hardest impact for the Italians has been to adapt to a different mentality and a different bureaucracy. Besides this, in a system in transition everything changes quickly, and this is a source of tension.
>
> However, they receive also considerable help. The government offers fiscal and economic support in form of tax holidays, while city councils offer spaces, once belonging to State companies that went bankrupt. The Italian government gives support too.
>
> Italians have a management style that looks like a family, strongly based on personal relations. In German companies this would never happen. Sometimes I would like to work in a system

> close to the American, where the rules are clearer and stricter, and nobody raises his or her voice. (Interview Italian firm in Slovakia, local director, 09-05).

The importance – and the hardship – of this issue is highlighted by the fact that Italian manufacturers have been followed abroad by service companies, whose work tackle not only legal, accounting and administrative issues, but broader issues of 'cultural encounter' as well. For example, Dr. Vito Bovoli, owner of the consultant firm EDA, active in Slovakia through its local branch EDAS since 1992, summarizes the work of his company in the realm of 'culture' as follows:

> EDAS stresses the importance of continuity with the past. Socialist countries had even an excess of rules, and even nowadays not to establish an internal normative which tells what you can do and cannot do during work hours, what you can bring to work and what you cannot is very dangerous. Entrepreneurs have to balance continuity with the past and innovation, retaining the positive aspects of the old system, re-using them in a more modern way. Medals for excellent employees, prizes for senior workers, feasts organized for the village, health assistance beyond what is stated by the law are examples of what can be done. The objective is to motivate employees, let them share the objectives of the enterprise. In the fashion industry, which goes through seasonal cycles of intense work EDAS proposes a system of compensation, in which the hours worked overtime are compensated with a lesser amount of hours in down time. We try to match employees' free time with the seasonality of the most important crops. EDAS work is for 70% to let Italian entrepreneurs not to build a copy of their business in Italy, but to create new entities adapted to thrive in Slovakia (Interview EDAS, entrepreneur, 09-25-05).

This construction of shared values is part and parcel of a broader process of building an hegemony in Gramscian terms. In an unpublished paper, Cacciarru described this process as follows. "The hegemony of a political class meant for Gramsci that such a class had-through its control over the political, educational, and cultural modes of incorporation no less than through its ownership of the means of production-succeeded in persuading other social classes to accept its moral, political, and cultural values as the sole legitimate ones. To the extent that a ruling class is successful in this mission it will use the minimum of physical force, as the normal exercise of hegemony is characterized by a combination of consensus and force which vary in their balance with each other, without force having to exceed consensus in any regular manner… As used by Gramsci, hegemony is much more than a synonym for ideology. It is "neither secondary nor super-structural, but it is lived at such depth and "saturates . . . society to such an extent; even constitutes the substance and limit of common sense for most people under its sway that it corresponds to the reality of social experience very much more clearly than any notions derived from the formula of base and superstructure" (Williams K. 1980, 37) (Cacciarru, A., unpublished material).

However, Italian firms can succeed in bringing their own set of cultural values abroad because they tap into the powerful hegemonic project of the European Union. In sum, the EU enlargement, through the transnational institutional chains described in the previous section, built a widespread consensus around a specific version of the neo-liberal project, among which the attraction of FDI comes together with the adoption of a set of common norms governing the economy and infrastructural plans that 'smooth out' the work of companies. Italian firms contracting and investing abroad present themselves as part of this project, plus they add their own, country specific, consensus, relying in the prestige of the Italian products. Besides prestige, there is a power of coercion relying in the fact that the mother company in Italy controls the access to the final market and most often the supplies as well. This adds a geopolitical dimension to the geography of Italian outsourcing/FDI. In the Ukrainian case studies presented in Chapter 6, the way in which being outside of the EU space changes the conditions of investment will be analyzed.

2.4.2 Italian firms and institutions abroad as hybrid spaces.

This role of 'channels' through which Italian firms abroad and transnational institutional chains import the 'best practices' of capitalism and the EU led neo-liberal reforms configure them as transnational, hybrid spaces, which are not fully under control of any nation state (Mitchell: 1997), i.e. they are the embodiment of the 'grey zones' highlighted in the globalization literature since the 1990s (see Strange: 1996). In her analysis of hybrid spaces, Katherine Mitchell has focused on the socio-cultural relations and family ties that allowed Hong Kong Chinese capitalism to be very successful in a decade of financial de-regulation (Mitchell: 1995). Working on the Chinese community in Vancouver, she developed an understanding of hybridity that links business, communities of expatriates and discourses on race and multi-culturalism. In one of her papers, Mitchell (1997) highlighted that hybrid, transnational spaces can be easily appropriated by capitalist forces, and used for purposes of capital accumulation. The firms and institutions studied in this dissertation are examples of such appropriation.

Looking at Italian firms abroad, the degree of hybridity is the highest in the case of Italian-owned firms: these are legal entities of the host state, but their capital, their market, and often their input supplies come directly from the parent company in Italy. Hybridity is experienced by the joint ventures and the subcontractors as well: although the capital may be partially –or entirely – local, they have various degrees of dependence from firms in Italy for the market and supplies. Local states control them with regard to labor laws and provision of infrastructures, but the locus of control of their financial sources and incomes is located in Italy, as summarized by Claudio Gasparini, director of an Italian owned knitwear factory abroad:

> Evropeiskaia Fabrika received the machinery and all its needs from the mother company in Italy. All of it is a capital account and included in the investments. Therefore, it doesn't have amortization costs. It has only personnel and general (electricity, etc) costs, which are around 20 thousand euros per month. It produces around 17 thousand sweaters per month. By statute, as Daughter Company, it must not generate profit [because the profit has to be made by the mother company]. (Interview Evropeiskaia Fabrika, director: 07-18-2006)

The institutions are characterized by hybridity as well. The most 'hybrid' institutions are the Italian chambers of commerce abroad, which are, at the same time, Italian and local, and have both a status of private association and a public dimension within the Italian State. Dr. Michele Bologna, General Secretary of the Italian Chamber of Commerce in Slovakia, describes this hybridity as follows:

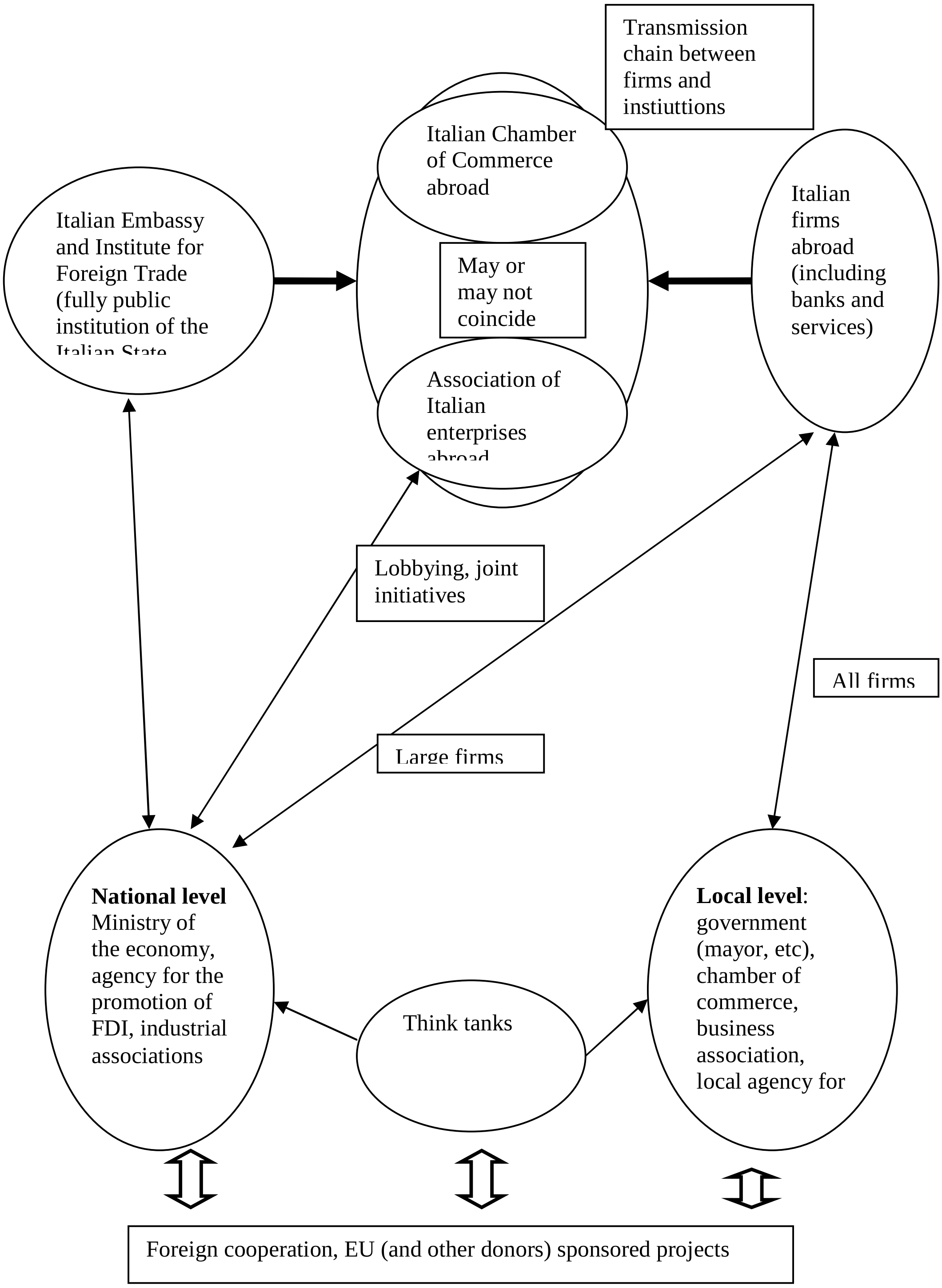
> The Italian-Slovak Chamber of Commerce was born in late 1997 as a part of an initiative of a group of Italian entrepreneurs in Slovakia. It followed the typical pattern of Italian chambers of commerce abroad. They start as associations of entrepreneurs. After at least two years, they can make a request of recognition to the Italian ministry of international trade. The phase of recognition has a quite various timing, from a few months to a few years. We received the recognition as Chamber of Commerce in the beginning of the year 2000. Thus we became a private subject with a public dimension. This is a peculiar status of Italian chambers abroad. They are private associations under the local law, but they are also regulated by an Italian law (Law 519 1970). This hybrid status makes them a case of international jurisprudence (Interview Italian Chambers of Commerce in Slovakia, General Secretary, 07-06-2006).

Associations of Italian enterprises abroad (the largest and more capillary present on the territory is Unimpresa Romania, reflecting the fact that Romania is the largest recipient of Italian investment, according to the number of investors) share part of this hybridity, being private associations, regulated by the private law of the local state, but having foreign members. The lowest level of hybridity is, obviously, given by the local institutions and think tanks, which are fully local, except for their role of 'capturing' ideas, producing policies blueprints and funds from the EU and other donors.

The interactions between these hybrid spaces are represented in Table 2.3. The table conflates the national and local scale, on the basis that both national and local level institutions may interact directly with Italian entrepreneurs. For example, an hypothetical Italian entrepreneur abroad may go to the local mayor for, let’s say, a request about electricity provision or (if the firms is large enough) go to the FDI promotion agency for some kind of State contribution. The embassy and the firms are connected by the Italian Chambers of Commerce abroad and/or Italian entrepreneurial associations, which constitute the link between the public (Italian and local) institutions and the private sector. From the perspective of the local institutions, both ministries of the economy (and particularly some of the connected agencies, like FDI promotion), local institutions and think tanks can constitute transnational links in order to gain from EU (or other donors) sponsored projects. These connections are expressed by the arrows in the central part of Table 2.3.

All of this may sound obvious, until looking at the overall consequence of the relationships chartered in Table 2.3. In the fieldwork it emerged that, especially considering the actors on the left side of the table (those located in the capital cities), many of the leading representatives of each kind of institution or association tend to know each other and share a common, neo-liberal ideology. In other words, especially in capital cities, all these actors tend to share the same social space and the same neo-liberal ideology; all together, these actors contribute significantly to the creation and harmonization of a neo-liberalist market economy.

Table 2.3 Hybrid spaces



2.5 Conclusions

The involvement of Italian firms abroad takes a wide range of forms, from subcontracting to the establishment of Italian owned firms overseas. Looking at Italian textile and clothing firms in Eastern Europe, this chapter discussed their impact on the local communities through the export of technology and management style into the local industry. However, this process sometimes raises delicate issues of adaptation between the Italian firms and the local environment, including the understanding and compliance with the local legislation, access to credit, habits in the workplace. These issues can hit severely the smaller Italian firms, which do not have enough financial resources to pay their own experts. In order to respond to these issues, Italian firms were followed by banks and services, which began to provide an interface between the Italian firms abroad and the local people and places.

These firms insert themselves in a rapidly changing post Socialist environment. One of the important ways local institutions are changing is through projects financed by the EU and other international donors. These projects often involve the co-operation between Western and local institutions; through this co-operation the practices and the structures of Western institutions are transferred into Eastern Europe. Consulting firms are at the center of this process, because they provide co-ordination and the know how to implement the projects. The outcome is the harmonization of norms and institutions among EU countries. From the standpoint of Italian firms, this means dealing with rules and regulations not too different from the homeland.

Global Value Chains analysis contributes to the understanding of these two parallel processes of change at levels of firms and institutions in two ways. First, this chapter argued that the EU funded projects create international connections among institutions which are structurally similar to value chains, because they involve relationships among independent actors, leading to some forms of 'upgrading' (the Westernization of the local bureaucracies) under power constraints (provided by the budget rules of the EU). Second, the chapter highlighted the ways in which forms of tacit knowledge are transmitted along both the value chains and the 'institutional chains.' These informal exchanges between Western and Eastern European state officials and entrepreneurs lead to shared values, among which neo-liberal ideology plays an important role in promoting further co-operation.

In conclusion, both the EU-led transformation of local bureaucracies and the investors-led transformation of local textile and clothing and other firms are heavily influenced by transnational connections. All together – and especially in the capital cities - these connections lead to the establishment of 'hybrid social spaces' in which representatives of firms and institutions contribute to the diffusion of neo-liberal ideology in Eastern Europe.

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Chapter 3
Banks and business services as sources of governance for Italian firms in Eastern Europe

3.1 Outline

This chapter analyzes the influences of banks and business services on the patterns of internationalization of Italian firms in Eastern Europe. In so doing, it shows the ways in which, after a decade of productive de-localization in Eastern Europe, a system of governance of the Italian economic presence in the region is emerging. A large literature on economic globalization has highlighted that nation state level institutions and civil society are no longer sufficient to regulate an increasingly globalized economy (Strange: 1996). Gereffi and Meyer (2004) argued that innovation in the public sector (such as the linkage of labor and environmental issues to trade agreements) and in the private realm (codes of conduct, quality certifications) are responding to this need for new forms of transnational governance. This chapter aims at demonstrating that banks and services constitute a connection between the forms of governance established in the public and private realm.

In so doing, it focuses on the value chains of Italian banks and service firms in eastern Europe, adopting what Gereffi and Meyer have called 'international industrial organization' approach to economic globalization (Gereffi and Meyer: 2004), which "focuses on the organization of production in the international economy and its implication for industrial upgrading, the status of workers and state-firms relations" (ibid., p. 7). Starting from the work of Vernon (1971), who first noticed that multi-national companies were shifting part of their production in developing countries, this approach analyses the disintegration of production led by the possibility of co-coordinating production processes in distant areas of the world (Krugman: 1995, Feenstra: 1998). Global Value Chain Analysis builds on these works, and focuses on industrial reorganization, governance and power along the value chain (Gereffi and Kaplinsky: 2001, Humphrey and Schmitz: 2001). Since the work of Vernon, who analyzed the power shifts between transnational corporations and nation states, these scholars have been concerned with the relationships between these geographically dispersed networks and firms and the States hosting them. Later, and especially thanks to the work on global value chains (Barrientos: 2007, Gereffi: 2005; Gereffi et al. 2005), the relations between firms, workforce and, more broadly, society were analyzed.

Looking at the forms of governance in the global economy, Gereffi et al. (2005) focused on the mechanisms of governance internal to the value chains, analyzing the various roles of chain leaders in organizing firms in the chain; Gereffi and Meyer (2004) distinguished between public and private forms of governance. They identified three roles of governance: facilitating the operations of the market, regulating the negative externalities of the market (such as pollution and workers exploitation) and compensating uneven development through redistribution of wealth. As for the facilitation role, property rights, banking and commercial policies, competition policies are public forms of governance. Market ideology, professional norms and codes of conduct are private forms of governance.

This chapter looks at the *activity* of Italian banks and services in Eastern Europe as a form of governance. First, it looks at the ways in which they support the connections between Italian firms and both the financial and State institutions of the host countries and the local civil society. Second, it analyzes how the activities of Italian banks, business services and manufacturing firms in Eastern Europe co-developed throughout the 1990s into an 'Italian system abroad.' The chapter is organized around the following research questions. How is the internationalization of banks and service firms related to the internationalization of manufacturing firms? What kind of power relations are established between Italian banks, service firms and manufacturers abroad? What kind of system is constituted by the inter-relations between banks, services and manufacturers? Is this system specifically Italian? To answer these questions, this chapter analyses the history and the geography of the Unicredit Group, the Italian banking group with the largest investments in Eastern Europe, and IC & Partners, a consortium of service firms present in almost every Eastern European country.

3.2 Unicredit Group[7]

3.2.1 Relationship between the internationalization of banks and manufacturing firms

The history of the constitution and expansion to Eastern Europe of the Unicredit Group constitutes an example of the ways in which economic change within Italy and Eastern Europe came together in a set of push and pull factors leading to changes in the Italian banking system, followed by international expansion. The acquisitions in Eastern Europe represent a new historical phase for the Italian banking system, which has been traditionally weak as far as overseas operations. This weakness reflected in a historical and geographical un-balance in the presence of Italian manufacturers and banks overseas. As the then minister of industry and foreign trade Enrico Letta made clear, still in 2001 the

[7] Sources of information for the analysis of the Unicredit Group are: Interview with Dr. Aldo Andreoni, Corporate Division, New Europe desk, Bulbank, Unicredit Group, 05-22-2006; Interview with Giancarlo Fornasier, Head of the New Europe Desk, Unibanka, Unicredit Group, 06-28-2006, the Unicredit webpage (www.unicreditgroup.eu), the web pages of the Slovak and Bulgarian banks of the Unicredit Group (www.unibanka.sk and www.bulbank.bg).

geographies of Italian manufacturers and banks abroad were only partially overlapping (Letta: 2001). Particularly, while firms were already active in exploring possibilities of export and internationalization in Eastern Europe and Asia, the banks were still focusing their activity in Western Europe and North America (Ibid.). However, in the years around 2000, the constitution of the Unicredit group and its acquisitions in Eastern Europe increased significantly the international presence of Italian firms, as described by Dr. Andreoni, high level manager of Bulbank, the largest Bulgarian bank, acquired by Unicredit in the year 2000:

> The Italian banking system always suffered from not being enough international. An exception used to be the presence of today's Banca Intesa, then Banca Commerciale, in South America. BNL had a bank in Argentina. Probably because of the [small] size of our banking groups, and because of the authorizations required by the Italian banking authority, the levels of internationalization were quite low. This was the case until a few years ago. Then, the change was due to the internationalization of the Unicredit group in Eastern Europe, which was considered the natural area to invest the profits from our work in Italy. (Interview Andreoni: 05-22-2006, language: Italian).

The internationalization of manufacturing firms from the industrial districts in the homeland played an important role in the initial push towards the internationalization of banks. Specifically, this took the form of a bottom up pressure from corporate clients in the context of the peculiar relations within the industrial districts, especially in the North East of Italy.

The early waves of Italian investments in Eastern Europe were driven largely by small manufacturers, who established contracting relations, and sometimes even migrated, in response to the competitive pressure in Italy, acting independently from institutional support. Current, more established, Italian entrepreneurs and opinion leaders, describe these first waves in a framework of a moral discourse: they are seen as pioneers or, more often, in a negative light as 'adventurers.' They tell a story of progressive stabilization and growing involvement: from short term, speculative, low capital investments to longer term, market oriented and capital intensive investments. This vision is shared by Eastern European experts, managers of Italian banks, representatives of Italian associations abroad, and Italian entrepreneurs. A high level manager of Unicredit in Slovakia focuses on the 'higher quality' of the latter waves of entrepreneurs:

> Some years ago many of the Italian entrepreneurs coming to Slovakia were on the brink of bankruptcy. They came to Slovakia because they didn't have room for work in Italy. There are many reasons for failure, but a large part of the people coming here weren't real entrepreneurs. This led local people to have a negative attitude towards us. They had to deal with many people that sooner or later revealed their lack of entrepreneurial skills, and this led to a bad image of Italian companies. Later, things began to change. The first good entrepreneurs were those with already established trade relationships in Eastern Europe. They created daughter companies. This was typical for the woodworking sector. Instead of importing logs, they set up wood processing plants and imported boards. These were small investments, with short amortization time. Things were done this way, because entrepreneurs were afraid of political instability and the overall difficulty of the country. This was due to the fact that they didn't give enough time to study the country. Now things are changing. Some are still coming attracted by low wages; they hope to raise their competitiveness by reducing costs. This is not good entrepreneurship, because this will last only until the wages won't grow, and they are growing already (interview high level manager, Unibanka: 06-28-2006).

Instead, an entrepreneur who owns a logistic firm supporting the import and export operations between Italy and Romania highlights the lack of organization of the whole process of Italian internationalization:

> Italians came [to Romania] in large numbers, in waves. The first who came were attracted by pure cheap labor, the famous *terzisti* [subcontractors]. They had no margins in Italy anymore, so they came here. The good times didn't last. Very few remain of those who came in 1994. Those who had a counterpart, a parent company in Italy resisted, all the others are gone. So, there were those desperate hoping to solve their problems here, and then there were adventurers hoping to come here with a few coins and buy a palace. I do not have a good vision of our presence in Romania, because as usual, we were dispersed, with no direction, with no support from institutions, and we came this way (interview Italian entrepreneur in Romania: 04-10-2006).

A Romanian trade analyst, native of Timisoara, the city with the largest presence of Italian firms in Eastern Europe, highlights that the disorganization and scarce professional skills of the early investors impacted negatively the imagine of Italians in the city:

> After 1989 [Italian] entrepreneurs began to come [to Romania]. Obviously, the pioneers were people who wanted to make big businesses with little money. Thus, the early 1990s contributed to the bad imagine of Italians, because any kind of people came, also those who gave us problems. With time, real and serious enterprises, which wanted to make a serious and maybe long term investment, came (Interview Romanian trade analyst: 04-10-2006).

Finally, the president of a regional branch of Unimpresa Romania, the largest association of Italian entrepreneurs outside Italy, links the lack of structure of the early waves of investments with the small size of Italian firms. In this context, the goal of entrepreneurial associations is to provide the services that small firms cannot afford:

> The difference between us and the other investors, Germans, French, Austrians, they usually have much larger investments than each Italian company. As a consequence, they already have a support structure for the investment. Instead, Italian businesses lacked a reference structure, somebody which could give them information, support, association. Around three years ago, with the support of Confindustria and Confagricultura an association of entrepreneurs was constituted, and was called Unimpresa Romania. (Interview president of the Timis County branch of Unimpresa Romania: 04-03-06).

Looking at this phenomenon of growing economic involvement from a geographical prospective, the North East and North West of Italy have been the main areas of origin of the firms operating abroad. Table 3.1 shows how foreign direct investments (i.e. ‘heavy’ forms of commitment abroad, as opposed to ‘light’ forms of commitment, such as subcontracting relations that do not require capital risk) from 1997 to 2001 came mostly from these areas.

Table 3.1 Percentage of outward foreign direct investments from Italy's macro areas, 1997-2001

Source: adapted from Federico (2004)

	North West	North East	Center	South	Italy
Textile, apparel, leather	3.9%	1.7%	0.5%	0	9%
Manufacturing as a whole	73.2%	15.4%	9.4%	2.0%	100%

Italian industrial districts as a whole generated 27% of these Italian outward foreign investments between 1997 and 2001 (Federico: 2004, p. 396). Corò and Volpe (2006) developed a method account for the growth of internationalization of Italian industrial districts. Looking at the international fragmentation of production along various value chains, they developed an index to calculate the employment abroad created by Italian firms, which included both FDI and subcontracting relations. In the textile and clothing value chains only, the employment abroad in 2003 was almost three times than in 1996, as Table 3.2 shows.

Table 3.2 Induced Foreign Employees in the textile and clothing sector in the Italian Districts

Source: Adapted from Corò and Volpe: 2006

	Eastern Europe	Mediterranean	China and India	Total	NI 1996=100
2003	117,054	16,792	69,802	203,648	280
2001	103,889	14,987	50,005	168,880	232
1996	38,612	9,227	24,975	72,814	100

Table 3.2 shows both a dramatic increase in the employment generated by Italian industrial district based textile and clothing industries abroad, and a concentration of this

employment in Eastern Europe. As the existing literature made clear (Rabellotti: 2004, Cainelli and Zoboli: 2004, ICE: 2006) the indexes of internationalization are stronger in the industrial districts of North Eastern Italy (especially Veneto), characterized by the strong ties between firms and local banks largely described in the industrial districts literature. Corò and Volpe's findings support this argument, showing how in 2003 textile and clothing firms based in the Treviso province (Veneto) employed two people abroad per every employee in Italy (Corò and Volpe: 2006, p. 15). This is the highest index of internationalization in the textile and clothing industries among Italian provinces. This very high level of internationalization of textile and clothing, and of manufacturing more generally, in the Treviso area is matched with the fact that two local banks – Italo-Romena and Cassamarca Trevigiana – were among the first Italian banks establishing in Eastern Europe.

There is no evidence in the literature of the processes connecting the internationalization of local firms and local banks in the industrial districts. However, the experiences collected in the interviews on the Treviso case suggest that this entailed a negotiation, which in the end changed the outlook of (some) of the once closed systems of the Italian industrial districts. Mr. Fornasier, former manager of Cassamarca Trevigiana (that later merged into Unicredit) described this negotiation as follows:

> It was difficult to access to credit in Italy. For example, if a customer came to my bank in Treviso asking for money to go to do business in Slovakia, it was very difficult to grant them credit. He sounded like a dangerous adventure. The Italian banking sector was quite concerned about these choices to go abroad. Later, the bank where I worked, Cassamarca Trevigiana, began to receive more and more requests of support from its customers wishing to invest in Eastern Europe. Besides Romania, where there are 18 thousand Italian companies … there was a general trend to move to Eastern Europe. Clearly, our customers complained that they couldn't be enough competitive, because other foreigners had support from their governments and banks, while they were alone. Because of this, in 1996 Cassamarca decided to establish the first JV in Slovakia with Polnobanka. There was an exchange of shares; we acquired 15% of the shares of Polnobanka…. The goal was to get to know this market and help commercial relations between our customers and Polnobanka customers (Interview high level manager, Unibanka: 06-28-2006).

The current country manager of Italo-Romena, an Italian bank active in Romania, highlights the important role of firms from the Veneto Region in the decision of Veneto Banca to acquire Italo-Romena:

> Banca Italo-Romena already existed in the 1980s, and it was owned by three Italian banks and one Romanian, the Commercial Bank of Romania.
> Later, almost the entire body of subcontractors from the Veneto region moved to Romania to produce here in OPT regime. Veneto Banca perceived the need of entrepreneurs from Veneto to have a bank that could act as contact point between Veneto and Romania. Thus, the acquisition of Italo-Romena is essentially due to the outsourcing from Italian entrepreneurs. We came at the end of 1990s, we have been here for already six years, and we had great satisfaction. Essentially, we began following Italian entrepreneurs, and year by year our customers became more and more heterogeneous (Interview country manager, Banca Italo-Romena: 04-07-06).

However, as Mr. Fornasier made clear, "Cassamarca was very strong in North Eastern Italy, but not strong enough to support [large] investments abroad (interview high level manager, Polnobanka: 06-28-2006). The case of Cassamarca is a paradigmatic example of strengths and weaknesses of the institutional arrangements at the heart of the industrial districts system: very rooted at local level, the bank was equipped to listen to the demands of the local businesses. However, this local scope put constraints on the financial power of the bank, which became very evident when the local system began to open to overseas operations.

3.2.2 The specific role of Eastern Europe in shaping the internationalization of Italian banks: the example of Unicredit

This situation was considerably improved thanks to the wave or mergers that have been changing the Italian banking system since the late 1990s/early 2000s (See, for example, De Rosa, 08-25-2006 for a description of the most recent merger). The constitution of the Unicredit Group is part of this broader trend, and it is relevant for this dissertation for three reasons. The first is the relevance of local banks in the process of constituting the group: Unicredit started with a few local banks merging and therefore acquiring enough power for a further merger with a nation-level bank. The second is the special commitment of the group to Eastern Europe, which results in the objective of acquiring the largest bank of each Eastern European country with the exception of Moldova and Belarus (out of the group's plans for political reasons).

The steps of the constitution and the expansion into Eastern Europe of the Unicredit Group were as follows. In 1996, Cassamarca established a joint venture with the Slovak bank Polnobanka. In 1998 a handful of local banks based in North Eastern Italy (including Cassamarca) merged, constituting Unicredito. In the same year, Unicredito merged with the state-owned, large-firms oriented bank Credito Italiano, constituting Unicredito Italiano. Already in 1999 the process of acquisition of banks in Eastern Europe began. The first was Bank Pekao, the largest Polish bank. In the year 2000 Bulbank, the largest Bulgarian bank was acquired. In the same year, the group explored Slovakia, and decided to expand on the basis of the joint venture with Polnobanka inherited from Cassamarca. Therefore, Polnobanka was acquired and named Unibanka. In 2002 followed acquisitions in Croatia, Romania, Czech Republic and an agreement with an important bank in Turkey. The last step of expansion to Eastern Europe was, in 2005, the merger with the Austrian group HVB. At the moment of the fieldwork research (summer 2006) the merger was at the initial stages of implementation. Once completed, it will allow the group to cover the entire area of Eastern Europe, including Russia and Turkey and excluding Moldova and Belarus. Besides this, it will lead to a shift from being an Italian based group to being multi-national.

Looking at this success story of a handful of local banks turning into a financial multi-national in less than a decade, the centrality of Eastern Europe in the group's expansion strategy is self evident (for more details, see Unicredit: electronic document). Besides Turkey, the only acquisitions outside the area were the US based companies Pioneer and Momentum in the areas of hedge funds management. A Bulbank manager summarized the reasons why the group invested so heavily in Eastern Europe as follows:

> Those countries have objective advantages, such as a GDP growth much higher than Western Europe, and banking activity used to be low, if not very low. Thus, there were good chances of development for our sector. The third reason was that the banks we acquired through privatization were sold at reasonable prices, which allowed us to invest without making debts and put our Italian investors at risk. This was the positive pull. The negative push were episodes that reminded us of the impossibility of further growth in Italy. … [Also], in these countries there are not large interests from American and, in general, non European banks, thus it is a natural market for Europe (Interview high level manager, Bulbank: 05-22-2006).

In sum, a combination of relatively low cost acquisitions, market opportunities due to the economic growth of Eastern Europe, and absence of strong extra European competitors shaped the geography of the expansion of Unicredit, which is summarized in Table 3.3. The two left columns describes the steps of expansion of the group through mergers and acquisitions in the banking and financial sector. The columns on the right highlight the geographical areas covered by this expansion, showing the Western European core of the group (Italy, and later Italy and Germany as consequence of the merger with HVB), and the

Eastern European expansion of the banking activity, plus the expansion in North America in finance.

Table 3.3 History and geography of the expansion of Unicredit
Source: Author elaboration from Unicredit webpage

	Event	**Location**	**Western Europe**	**Eastern Europe + Turkey**	**North America**
1998	Group Creation. Merger of six local banks plus one nation-level bank	Italy	Western Europe		
1999	Acquisition of Bank Pekao	Poland		Eastern Europe	
2000	Acquisition of Pioneer Investment	USA			North America
	Acquisition of Bulbank	Bulgaria		Eastern Europe	
	Acquisition of Polnobanka (now Unibanka)	Slovakia		Eastern Europe	
2002	Acquisition of Zagrebacka Banka	Croatia		Eastern Europe	
	Acquisition of Demirbank Romania (now Unicredit Romania)	Romania		Eastern Europe	
	Acquisition of Živnostenská Banka	Czech Republic		Eastern Europe	
	Agreement with Koç	Turkey		Middle East	
	Acquisition of Momentum	USA			North America
2005	Acquisition of Yapi Kredi by Koç	Turkey		Middle east	
	Merger with HVB	Germany, Austria, Russia, Poland, Croatia, Bulgaria, Bosnia-Herzegovina, Romania Lithuania, Ukraine, Serbia.	Western and Eastern Europe	Western and Eastern Europe	

3.2.3 Asymmetry of power in the banks-firms relations

Notwithstanding firms provided the initial push for the internationalization of banks, there is a clear power relation which advantages banks. Particularly, the policy of acquisitions privileges large and already established Eastern European banks; in this situation, Italian firms abroad tend to be a fairly small fraction of the overall clientele of Italian-owned banks in Eastern Europe. Especially the Unicredit Group privileged the acquisitions of the largest banks of each Eastern European country; thus, the marginality of Italian customers in the overall turnover of giants as the Bulgarian largest bank 'Bulbank' is self evident, as a high level manager pointed out:

> [Bulbank] has such size that the income coming from credits supporting Italian investments is quite marginal; the presence of Italian companies is not extremely significant as far the profits of our bank. This is due to our size: we control 20-25% of the Bulgarian market, and for sure Italian investors are not so representative. (Interview high level manager, Bulbank: 05-22-2006).

Therefore, firms do not have a strong contractual power in negotiating the prices and the overall conditions of credit, which tend to align to the market conditions of each host country. This contractual weakness of firms is partially compensated for by the possibility of both working with Italian speaking staff and having a direct link with the Italian credit system, which helps when an Italian company abroad decides to ask for credit guaranteed by the mother company in Italy. Unicredit has institutionalized this support, establishing a department (called 'New Europe Desk') in each of its eastern European banks, having the specific aim of following the foreign (and therefore, mostly Italian) customers of the group. The logic behind the constitution of the 'New Europe Desk' has been summarized as follows by the department heads in Slovakia and Bulgaria:

> Thus, the presence of these regionally oriented shareholders in the administration of the bank compels us to be attentive to the needs of Italian entrepreneurship abroad. Concretely, among the six Italians appointed to work in Bulbank one (which is me) has the duty to follow in general European, but mostly Italian, investments in Bulgaria. This happens for a few reasons. First, because of the abovementioned link between Unicredit and local banks. Second, although we are a European level bank, Italy is our most important market. Thus it is our interest to support the internationalization of Italian companies and their evolution, because the economic and financial health of Italian companies is in our hearts. This is not because we are altruistic people, but because often our group finances these companies' headquarters in Italy. (Interview high level manager, Bulbank: 05-22-2006).

> A foreign entrepreneur coming here has many problems. The first is the language barrier; the second is the different legislation, the third is the different banking system. Also, local banks had problems to understand the value of the foreign entrepreneur. If a foreign company establishes a daughter here, of course the daughter depends on the mother. Thus, from bank's perspective, to evaluate the mother is more important than to evaluate the daughter. However, when entrepreneurs came showing balances written in Italian, using the system of the 4th EU directive, which is different from the Slovak system; you may well understand that the Slovak colleague could not understand who was sitting in front of him or her. Thus, Unicredito Italiano established in each of the controlled banks a division, the 'New Europe Desk' to mediate between the needs of the [Italian] customer and the needs of the bank (interview high level manager, Unibanka: 06-28-2006).

3.2.4 Specificity of the Italian system of internationalization

The power relations between banks and firms are thus crucial in understanding the emergence of a system of governance of Italian economic activity in Eastern Europe. Firms have been one of the drivers of internationalization of the banking industry. Also, because of the importance of the Italian market in the overall turnover of the Italian-based banking groups like Unicredit, there is an objective interest in supporting Italian firms abroad. A successful daughter company in Bulgaria or Slovakia supports the success of the mother company in Italy, which will mean a more solid customer for Unicredit in Italy. However, because loans to Italian firms abroad are just a small percentage of the overall banks turnover, firms will, on average, have a very weak contractual power with respect to banks.

Another aspect of the Italian system of internationalization is the non-exclusive relation between firms and banks: Italian firms in Eastern Europe may or may not work with

Italian banks. This is quite different from other groups of Western European investors in Eastern Europe:

> Italians, by tradition are not loyal. This is an important aspect of our business. In fact, it is nearly impossible for a non German bank to have a German company among its customers. The same happens in the case of French. This is because before coming here German or Austrian companies already have an agreement with their bank. Banks support them in the internationalization process, but companies accept to work with their own banks only. Italians instead come here and look around for the best offer. There is no loyalty at all, thus this bank has to give the best services (interview high level manager, Unibanka: 06-28-2006).

The reason behind this 'lack of loyalty' is that these exclusive agreements between banks and firms are not common in Italy. Instead, each firm explores options of investments in Eastern Europe on its own and, once established, it looks for financial support locally. Therefore, firms responded to the weak contracting power towards banks by exhibiting lack of loyalty. In this system, banks have to win customers through services - among which 'cultural support' – i.e., bilingual offices and easier credit evaluation, play a central role. As emerged in the interviews, a mix of support and conflict characterizes this system. Interviewees in the banking sector highlight their role in supporting Italian firms, through language services and first hand knowledge of the local area and local professionals:

> In this market sometimes we have been less strict then elsewhere, because we understood that often these entrepreneurs didn't have much choice. While in Italy there are several options as far banks, here we could send companies to Bulgarian competitors, but it is clear that we are the first option, and we always felt we should do everything possible to support Italian investors (Interview high level manager, Bulbank: 05-22-2006).
>
> I worked also for Austrian banks here in Romania. Austrians come to Romania, and they go to the Austrian bank, live and die with their bank, without seeking anything outside that relationship, and, as far as I remember, without ever discussing conditions. Italians, as we know are different. Maybe they come to us initially, because we also try to provide a consultancy service. An Italian coming here for the first time needs everything. We tell him "look, if you want to go to a good consultant, we have five or six names, if you want to go to a notary, we have a few names too" …. We give some indications, so the customer will be a little more protected, because here there are a lot of cheaters, and Italians were cheated a lot … Thus, Italians come first to us, we talk, discuss, help, then, clearly, they go around. They

> check where they can find the best conditions and the best rates (Interview country manager, Italo-Romena: 04-07-06).

Instead, interviewees from the firms' side complain about the fact that Italian banks rely on the local market in deciding credit rates and conditions, without giving any real preferential support to Italian firms:

> What I hope it will change soon is the policy of banks. [In Romania] banks are having big earnings, so big that they have no interests in taking risks in opening credit lines. They ask too much guarantees. They are having large profits coming from the banking cycle itself. When you make a deposit you have to pay a commission, when you take money you have a commission. Since people must use banks, and most of salaries are paid through banks, at aggregate level this is big money.
> This behavior concerns both Italian and banks from other countries. The problem is that we [Italians] are small businesses, so we do not have contractual powers against banks. Obviously, large groups like Geox or Zoppas can go directly to the bank headquarter, but small businesses can't.
> I am a good client of Unicredit. We had some negotiations for a leasing, and I was about to close my relations with them, because they asked to guarantee with my personal estate, and with the estates of all the stockholders of this company. I told them 'you are nuts and out of any logic' and they answered 'this is our policy.' Then I called the director of the bank…. Italian businesses do not necessarily go to Italian banks. My firm works with Raffaisen [Austrian]…, with Unicredit, with Italo-Romena, and BRD [French]. (Interview with Italian entrepreneur in Timisoara, Romania)

> The relation with banks is an aching tooth. Banks are really negative. Italian banks adapted themselves to the local conditions. They don't help us much. People talk about 'Italian team,' of joint efforts, but these are words, not facts. Quite the opposite: here banks ask for more guarantees than in Italy, therefore they give firms a harder time.
> Q.: Do Italian entrepreneurs go to Italian banks?
> A.: Not always. Sometimes other banks, French, Austrian, and also Romanian, give us better conditions than Italian banks. Obviously, an Italian entrepreneur goes to the Italian bank because he thinks to have a more direct and familiar relationship. Oftentimes this is an illusion. … Banks say: 'we came because entrepreneurs wanted us.' This is false. They say 'we are a business.' What does it mean? They want extra profits? There is no point to say that Italian firms called them. Large companies told them to come, and demanded the same interest rates as in Italy. SMEs do not have this power. In the end, even large companies are not so protected. Banks just aligned to the local interest rates. We can't think of doing an 'Italian team' and then acting this way. I am very angry with banks. I both hate and love them. [Bankers] who work here receive directives from their bosses in Italy. Those bosses think that the conditions here are the same as in Italy, but they are not (Interview with Italian entrepreneur in Bucharest, Romania).

3.2.5 Evidence from the fieldwork research

This fieldwork research provided data to support the hypothesis of an open system, characterized by a certain degree of attraction between Italian banks and Italian firms abroad, but not by exclusivity. Obviously, this information cannot portrait the exact degree of openness of firm-banks relations, since it was based on a random sample of forty manufacturing firms,[8] over a population in the order of ten of thousands,[9] which has been built to assess trends in the textile and clothing sector, and not the entire spectrum of Italian firms abroad. However, it can provide evidence of the phenomenon, at the same time suggesting future research to assess it in more detail.

The results are as follows, and suggest that the 'weak attraction' of Italian banks over Italian firms is actually quite effective, with over 40% of the firms interviewed working exclusively with Italian banks:

[8]Thirty four of them, are in the textile and clothing sector and in logistics, the six non textile firms were interviewed to deepen the case study of Kralovsky Chlmec and because of their directors connections with the associations of Italian entrepreneurs.

[9] 18 thousand Italian firms are registered in Romania only, while unofficial data I collected in Bulgaria suggests a population of around 5 thousand.

Table 3.4 Use of Italian banks by Italian firms overseas

Number of firms

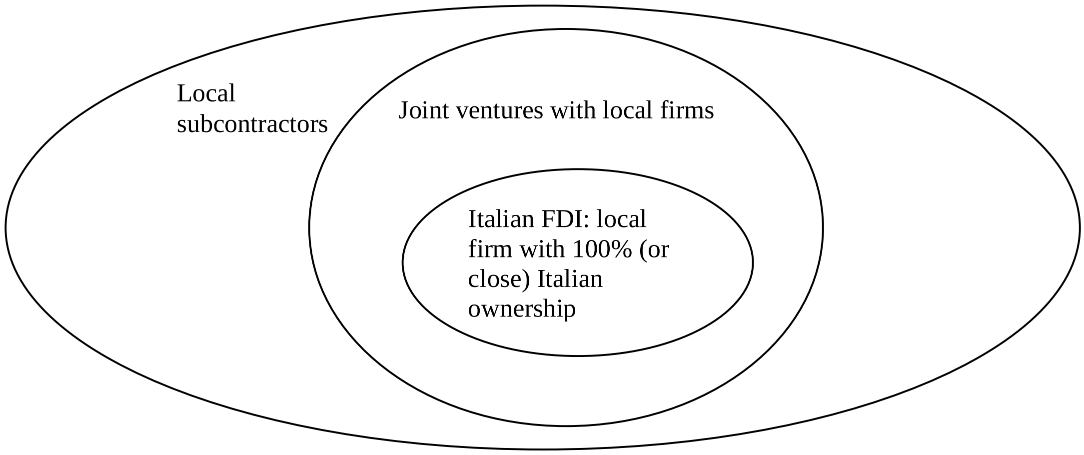
	ITALIAN BANKS	NON-ITALIAN BANKS	MIX OF ITALIAN AND NON ITALIAN BANKS	NO USE OF BANKING SERVICES	NON SPECIFIED	NO INFORMATION
ITALIAN FIRMS OR JV	9	5	5	2	0	9
LOCAL SUBCONTRACTORS	0	0	0	2	8	0

Percentages (respondents only)

	ITALIAN BANKS	NON-ITALIAN BANKS	MIX OF ITALIAN AND NON ITALIAN BANKS	NO USE OF BANKING SERVICES	NON SPECIFIED	TOTAL
ITALIAN FIRMS OR JV	43%	24%	24%	9%		100%
LOCAL SUBCONTRACTORS				20%	80%	

Of 40 firms interviewed in Slovakia, Ukraine, Romania and Bulgaria, 30 were Italian-owned, or joint ventures; the others were subcontractors of Italian firms (two firms interviewed in Romania), while in the case of Rousse (Bulgaria) were local firms working in OPT trade for foreign contractors, among which there were some Italians. Italian ownership does make a difference when approaching banks. Particularly, during interviews local firms spoke about ‘banks’ without making any reference to the provenience of the banking group. Instead, owners or directors of Italian-owned (regardless whether they come from Italy or not) tended to be more aware of the origin of the banks they work with.

This result allows making some considerations with respect to the scheme re-presenting Italian manufacturers abroad I developed in Chapter 2, which it is as follows:



Particularly, it suggests that the intensity of involvement of Italian manufacturers abroad reflects on the financing choices: the 'weak attraction' of Italian banks on Italian firms will work for Italian investments abroad at its best. Local subcontractors, being managed exclusively by local people, and having credit histories which do not involve mother firms in Italy will not have a specific reason (beyond market conditions) in turning to Italian banks.

Second, as far Italian investments abroad, the 'weak attraction' described above seems to work quite well, with 43% of the respondents declaring to work with Italian banks and 24% with a mix of Italian and non-Italian banks.

Third, the fact that local subcontractors have a significantly higher percentage of non use of banking services may reflect a more difficult access to credit: Italian firms and joint ventures interviewed were in most cases larger than local subcontractors, and backed by mother firms in Italy. Therefore it is likely they can provide more guarantees when applying to loans than average local subcontractors.

Table 3.5 Geographical specificity

(# of firms)

	ITALIAN BANKS	NON-ITALIAN BANKS	MIX OF ITALIAN AND NON ITALIAN BANKS	NO USE OF BANKING SERVICES	NON SPECIFIED	NO INFORMATION
EASTERN SLOVAKIA	3	3	1			3
WESTERN UKRAINE		1	1	1		3
BULGARIA		1		1	6	3
ROMANIA	6		3	2		1

Percentages (respondents only)

	ITALIAN BANKS	NON-ITALIAN BANKS	MIX OF ITALIAN AND NON ITALIAN BANKS	NO USE OF BANKING SERVICES	NON SPECIFIED	TOTAL
EASTERN SLOVAKIA	43%	43%	14%			100%
WESTERN UKRAINE		33%	33%	33%		
BULGARIA		12.5%		12.5%	75%	100%
ROMANIA	55%		27%	18%		100%

Breaking down by geographical area investigated, the numbers are too small for any conclusion. However, they reflect the overall conditions in the area. Particularly, Western Ukraine, being geographically the farthest area from Italy and still outside of the EU, is at the periphery of the expansion of the Italian system. This reflected in the fact that the availability of Italian banks in the area is still low – albeit during 2007 and 2008, with the completion of the merger between Unicredit and HVB the situation should change. As for Bulgaria, the absence of Italian banks in the sample reflect that this research privileged the study of the textile industrial district of Rousse, which is composed mostly by local firms with subcontracting relations overseas, which did not declare the origin of their banks. In the case of Slovakia, one of the enterprises reported that they were established there before Italian banks, and are not using their services because they already had an established relation with a local bank. In Romania, the firms not using banking services are all local subcontractors.

In the interviews there was not a specific question about the reason why a particular bank was chosen. However, three respondents mentioned being already their customers in Italy, while one suggested the importance of proximity, stating that 'most banks in this area are Italian.'

3.3 IC & Partners Group[10]

3.3.1 Relationship between the internationalization of manufacturers and the internationalization of service firms

Besides banks, the early waves of Italian manufacturers were followed by service firms. Those firms play an important role as far the adaptation of the Italian owned small firms to the local environment, providing them with accounting services and country specific knowledge as far legislation, investment opportunities and, at large, knowledge of the local place. Those firms integrate the support to internationalization provided by the Italian State through the Institute for Foreign Commerce and agencies like Informest. State support focuses on providing general information about legislation and opportunities, access to financing (through the dedicated agency Simest) and promotional events, such as fairs and missions of entrepreneurs abroad. Service firms provide operative knowledge. In sum, State

[10] The following information on IC & Partners Group has been collected through interviews with Dr. Roberto Corciulo, chairman of the IC & Partners group, (October 2006), Dr. Sabrina Molinaro, 'Studio Arkimede' (10-14-2005), Mr. Ivan Palichev, IC & Partners Sofia (11-02-2005) Dr. Vito Bovoli, EDAS (09-26-2005), Dr. Mauro Marchetto, MTS Boscolo & Partners Bucarest (03-30-2006), Dr. Andrea Chiozzi, Boscolo & Partners Timisoara (04-05-2006), from the group webpage (www.icpartnersgroup.net) and the group's journal *IC&Partners Magazine*

support provides access to opportunities for commercial penetration and investments, while service firms support the actual execution of the investments.

Going overseas transforms the relation between service firms and manufacturers. From a geographical perspective, the most evident change consists in the spatial re-scaling of the relation between service providers and manufacturers. In Italy, service firms work locally. Put simply, no manufacturer is likely to travel across half of the country to look for a certified accountant or marketing services. Instead, in Eastern Europe Italian firms are likely to be more dispersed. At the same time, the offer of Italian-speaking services is going to be scarce. Therefore, Italian services in Eastern Europe support Italian firms dispersed in a much wider space than they would do in Italy, possibly covering entire countries. For example, the firm EDAS has supported “the relocation of thirty percent of Italian firms present in Slovakia, for a total of seven thousand jobs created” (interview entrepreneur, EDAS, 09-26-2005) with only two offices, one located in the capital, and the other in Kosice, a major city in Eastern Slovakia.

3.3.2 The specific role of Eastern Europe: the case of the IC & Partners Group

The IC & Partners group is a consortium of service firms having the explicit aim to provide a homogeneous, Italian standard set of services in the whole Eastern Europe. According to its chairman, it is the most extended network of Italian service providers in the region. Although the financial power of a consortium of independent service firms as IC & Partners cannot be compared with a large banking group like Unicredit, the logics behind the Eastern European focus of the two are similar. In both cases, the presence of Italian firms in Eastern Europe, the scarce opportunities of growth in Italy in the 1990s, and opportunities given by the transition of Eastern Europe co-occurred in shaping the geographies of their overseas expansion.

Unlike banks, whose branches overseas are quite large and independent from the needs of Italian manufacturers, the IC & Partners group target customers are Italian enterprises abroad. The group started as an association, that in the year 2000 constituted a consortium. It began as an initiative of five chartered accountants, each of them owning at least one firm in Italy and one in Central and Eastern Europe. Since the beginning, the aim has been to create synergies and a common brand to provide homogeneous services across the area. The logic behind this choice was that several firms have interests in more than one Eastern European country; therefore they needed a network of chartered accountants to support them. Because of this symbiosis with Italian firms abroad, the expansion of the group followed the historical and geographical patterns of Italian manufacturers abroad. Just considering the areas investigated in this dissertation, the group has a long standing presence in Slovakia (since 1991) and Romania (1994); arrived more recently in Bulgaria (2003) and at the moment (December 2006) is not yet present in Ukraine. This matches quite closely the information available on the involvement of Italian firms in the area: the early waves of subcontracting relations and later investments interested Central Europe (Interview Bovoli), followed by a massive interest in Romania in the mid 1990s. The interest in Bulgaria is more recent, ignited by the IMF led policies after the 1997 financial crisis and the Unicredit acquisition of Bulbank in the year 2000 (interview with representative of Italian embassy in Bulgaria). With the exception of a few long term established firms, the Italian presence in Ukraine is still experimental (interview with Italian entrepreneur).

As for the push factors within Italy, the average small size of Italian accountancy firms (see table 3.6) channeled their expansion towards Eastern Europe instead of the more expensive Western European markets or the farther Asian markets. The chairman of the IC & Partners group describes the situation as follows:

> Here, in this office, we have twelve professionals, which mean we are a large firm [for the Italian standard]. The situation is very different with respect, for example, Northern Europe. I had a partnership in Germany with a firm with 550 chartered accountants; overall they have two thousand employees in one hundred and fifty offices throughout Germany. Up there a small accountancy firms has thirty or forty chartered accountants, plus staff…. With such small dimensions it is difficult to go abroad to support small and medium firms in the process of internationalization. This is an important structural problem for the country, because it is much harder for a firm to go abroad without a reliable network of real services…. I couldn't have gone to Germany, because there the costs are too high, and the competition is very strong (interview Chairman, IC&Partners Group: 10-10-2006).

Table 3.6 Chartered accountants in Italy
Source: IC&Partners

	Registered	Non registered	Total	
Nr. of chartered accountants (*ragionieri* + *dottori commercialisti*).	~ 100,000	~ 50,000	~150,000	

	One accountant	Up to five accountants	More than five accountants	Total
Size of service firms, according to the nr. of accountants (% of all firms)	80%	15%	5%	100%

In this condition, the geographical proximity of Eastern Europe, together with the peculiar conditions of the market in the early phases of post socialist transformation in the 1990s provided the necessary conditions of low costs and low competition necessary for the internationalization of the group, consisting in the establishment of offices throughout the area. The chairman of the group describes the situation as follows:

> In Eastern Europe my profession has started in 1990; therefore the market was open. The concept behind IC&Partners is that with a strong presence in the homeland we could open towards East. Most important, we could do it with low investments, because in the early 1990s we did not have competitors, and local labor was cheap. This was possible because we started in the 1990s, now the costs in Eastern Europe are too high already, we definitely could not begin now. Today a chief accountant in Moscow asks 2,000-2,500 euros after taxes. Ten years ago they were two hundred euros. A structure like ours needs usually three years to reach break even: I could not do it with today's costs. (Interview Chairman, IC&Partners Group: 10-10-2006).

3.3.3 The social geographies of Italian service firms in Eastern Europe: IC & Partners as hybrid spaces

Looking closely at the Eastern European firms in the IC & Partners group, the hybrid spaces described in the previous chapter emerge both in the internal organization and in the kind of services provided. The internal organization, the group is driven by the objective of providing 'Italian standard' services in environments often characterized by laws, law enforcement and timing that do not coincide with Italy, even though the EU membership is leading towards harmonization of rules and laws. Working with different norms leads to the necessity of building in each firm the best possible knowledge of both the Italian and local laws and implicit rules governing business. Second, this must be achieved in the tight budget constraints discussed above. Third, in the interviews it emerged that the group is facing difficulties in recruiting people in Italy to work overseas. To respond to these issues, and at the same time providing an homogeneous quality in the services, the common policy of the consortium is that at least one person has to be Italian – with the exception of the Bulgarian firm, led by a local person, who speaks a perfect Italian and had a long standing experience working in partnership with Italian firms – in order to allow customers to speak their native language. In so doing, the group presents itself as a cultural mediator between the investors and the local environment by declaring in its mission statement that "IC&Partners Group has the goal of reconciling the expectations of economic operators and the reality of the markets in which they want to make their way" (IC&Partners: electronic document).

In Slovakia, the firm EDAS (www.edas.sk) is the IC & Partners Group local member. The firm has two offices, in the two major cities of Western and Eastern Slovakia, Bratislava and Kosice. The history of the firm is an example of transformation and consolidation of ties pre-dating the collapse of the socialist system. EDAS started in 1972 as EDA (*Elaborazione Dati Aziendali*: 'enterprise data elaboration'), a consultant firm providing support to businesses that were starting to use information technology. By the end of the 1970s they shifted to the support of the commercial relationship that firms in the surrounding region (Emilia Romagna) were developing with the then socialist countries, and especially the USSR. Those commercial relations were based upon contracts (barter counter trade, furniture covered with insurance against political risk) which involved complex financial mechanisms. EDA began to work with those mechanisms, and began to develop knowledge of the eastern European markets. In 1983 EDA's founder met Aleksander Dubcek, and in 1989 he accepted Mr. Dubcek's invitation to go to teach a series of seminars on marketing at the Economics University in Bratislava. Building on this experience, he started the company EDAS, which offers a full fledge package of support to the Italian businesses moving to Slovakia (see EDAS webpage for a complete list of the services provided).

In the vision of EDAS' founder and owner, cultural mediation is at the heart of the firm's work:

> EDAS work is for 70% to help Italian entrepreneurs not to build a copy of their business in Italy, but to create new entities adapted to thrive in Slovakia (interview entrepreneur, EDAS: 09-26-2005).

Examples of the ‘cultural support’ provided by EDAS to Italian firms abroad are first of all aimed at ‘organizing the human resources in a correct way’ (interview) in order to help entrepreneurs to understand spoken and unspoken rules in the organization of the labor force. To do so, they insist on listening to the inputs coming from the local people. Second, they provide detailed information on local norms and customs, highlighting the importance of continuity with the past.

> For example, in Slovakia contracts of employment specify in detail employees’ duties, while in Italy they tend to be much less detailed. Then they let them understand that the fact that Slovakia is less rich than Italy does not mean that there are no rules (health and security measures). EDAS stresses the importance of continuity with the past. Socialist countries had even an excess of rules, and even nowadays not to establish an internal normative which tells what you can do and cannot do during work hours, what you can bring to work and what you cannot is very dangerous. They have to balance continuity with the past and innovation, retaining the positive aspects of the old system, re-using them in a more modern way. Medals for excellent employees, prizes for senior workers, feasts organized for the village, health assistance beyond what is stated by the law are examples (interview entrepreneur, EDAS: 09-26-2005).

These advices highlight the uneven power relations involved in the process of internationalization. In EDAS owner words, “the objective is to motivate employees, to let them share the goals of the enterprise” (interview). More precisely, Italian entrepreneurs must be able to organize the technology, structure and goals of their enterprises, reproducing as much as possible their Italian plants, but at the same time managing the personnel in a way which is familiar to the local people, in order to minimize the frictions between the Italian management and the local labor.

In Romania, the member of the IC & Partners Group is the firm Boscolo & Partners (www.boscoloromania.ro). It has offices in Bucharest and in two major cities of Western Romania (Cluj-Napoca and Timisoara), reflecting the historical geography of Italian entrepreneurial activity in Romania, which initially privileged the Western part of the country because of geographical proximity with Italy. The history of the company is an example of the leading role played by the manufacturing firms in the internationalization of the Italian system. In fact, the Italian firm Boscolo & Partners opened its first office in Romania in Bucharest in 1994, following one of their Italian clients, a textile firm which at the time had subcontracting relations in Romania. The experience of internationalization is described as follows by a Boscolo & Partner representative:

> [At first, Italian manufacturers established subcontracting relations]. After that, the second step was to constitute joint ventures with local subcontractors, or even constitute 100% Italian owned businesses. In this context, many kinds of problems arose, from the relations within the company, to the problems linked with contracts, and others. Twelve or thirteen years ago the approach of the Italian entrepreneurs was (and, mostly, still is) not very organized. They go, they do, and they face problems afterwards. This is not a critique, this is how things are. Starting from a situation of this kind, some of our clients (very few at that time) asked us to follow them to solve some problems. Thus we had a first contact with Romania, and from that moment we agreed that there were potentials for developments, that 12 or 13 years ago were only slightly perceivable. Thus we took the risk and we invested (interview Italian chartered accountant, Boscolo & Partners Bucharest: 03-30-2006).

The logic of internationalization of Boscolo & Partners is directed towards the export of the Italian model of chartered accountancy firm, which is required to work through the local legislation:

> We grew, with a very simple model: we reproduced our Italian model. We are a full fledge "*studio dottori commercialisti*" [chartered accountancy firm] even though this professional qualification does not exist in the Romanian law. Here we became "*expert contàble*" and were enrolled in the chamber of auditors. With time, we became a structure similar to the one we have in Italy (interview Italian chartered accountant, Boscolo & Partners Bucharest: 03-30-2006).

In Bulgaria, the firm IC & Partners Sofia differentiates itself from the two previous cases. First of all, it is the only firm in the group that has been started by a local – instead of Italian – person. Second, it has a more recent history – it started in 2003. Third, it has a different structure, 'lighter' than the other cases.

The history of the constitution of IC & Partners Sofia is an example of entrepreneurship stemming from personal trust. Again, relationships starting in the manufacturing sector led to the constitution of the firm, as the manager of IC & Partners Sofia describes:

> I started to work with Italian entrepreneurs during my job as CEO of a Bulgarian factory which produced machine tools… One of my best clients was an Italian business, with whom we co-operated for about two years. Afterwards, the Italian colleagues offered me a job as responsible for their business in Bulgaria, Belarus and, Russia…. The Italian machine tools company used the services of the chartered accountants from the firm 'Arkimede,' which is a member of the IC & Partners group. Knowing this, Mr. Roberto Corciulo, president of the IC & Partners Group, and I decided to bring the group in Bulgaria. Thus, in 2003 I started this consulting firm, even though I am a mechanical engineer, not an accountant. (Interview manager, IC&Partners Sofia, 11-02-05).

As far structure, instead of constituting an office managed by one or more Italian persons who manage a pool of local professionals like in the previous cases, IC & Partners Sofia is centered on the managing director, who outsourced the legal issues to a local lawyer, and the financial and accountancy issues to a local accountancy firm, of which IC & Partners Sofia is a shareholder, local auditors for certifications, other consultants for special needs and, at the time of the interview (November 2005) a connection with a human resources firm was being established.

As in the other cases, the firm's aim is to facilitate the connection between the Italian entrepreneurs and the local environment, targeting especially small and medium enterprises, which are considered to be in greater need of such broad 'cultural' service:

> Our targets, in line with the IC & Partner group, are the small and medium enterprises, because the large firms do not need us. If, for instance, FIAT wants to do something, they use their own experts, and work directly with the government. Thanks to the personalization of our services to SMEs, we hope to achieve a quality very close, if not equal to what they have in Italy. Often the Italian entrepreneurs do not speak the local language and have a difficult time to understand the local situation. This happens notwithstanding Bulgarian norms are quite close to Italian, because we are already prepared to join the EU. (Interview manager, IC&Partners Sofia, 11-02-05).

3.3.4 Asymmetrical adaptation and power relations

In sum, reflecting on the IC & Partners experience from the standpoint of the reciprocal adaptation and the power relations generated by the relocation of Italian firms in Eastern Europe, the following issues emerge. First of all, as in the case of banks, Italian manufacturers abroad pushed the relocation of services. This action is connected with the small average size of many of the Italian firms relocating in Eastern Europe. This condition puts firms in a weak power relation with the local institutions: many of these firms are too small to afford to pay financial, fiscal and business experts to help them to understand and negotiate the explicit and implicit rules of 'doing business' abroad. Therefore, a demand for Italian speaking services emerged, in order to mediate between the Italian firms and the local bureaucracy. Second, there is a strong power relation within the firms: Italian entrepreneurs do actively export their technology and have precise expectations as far quality of the products. Often, management style is exported as well, especially in the case of Italian foreign direct investments. Ms. Bortakova, Slovak director of an Italian owned apparel enterprise, describes this situation as follows:

> Those who wanted to work well in Slovakia had to adapt to the local conditions. However, the idea behind the investments is always to bring the Italian mentality and way of working in Slovakia. The hardest impact for the Italians has been to adapt to a different mentality and a different bureaucracy. Besides this, in a system in transition everything changes quickly, and this is a source of tension. (Interview local manager, Italian apparel firm in Slovakia: 10-05).

Especially in the case of EDAS, the consultancy firm works in order to create compliance between the expectations of the Italian investor and the local labor. As in the case of banks, the relationship between Italian manufacturers and Italian services abroad is open: manufacturers go to explore the local markets on their own, and once there they survey the services available. Italian service firms do have a special attraction due to language and cultural mediation, but manufacturers do not have any obligation to choose them over local firms.

3.4 Conclusions

The case studies of Unicredit and IC & Partners showed a direct relation between the internationalization of Italian manufacturers, banks and service firms in Eastern Europe. Particularly, in the 1990s manufacturers moved first, services and then banks followed later. This happened as consequence of a combination of direct pressure from manufacturers on services and banks, the emergence of new market opportunities in Eastern Europe and the availability of assets at convenient prices as a consequence of post Socialist transformation. As far the kind of services provided, both Unicredit (through the New Europe Desk) and IC & Partners supports the adaptation of Italian firms to the local institutional and financial environment.

The internationalization of manufacturers, services and banks entailed a set of power relations. First of all, banks are in a stronger position over manufacturers. Italian banks and firms in Eastern Europe establish uneven and complex power relations. The main features of this system, as emerged in the fieldwork, are as follows. 1) Firms, and especially small firms, are price takers: loans to Italian firms abroad are just a small percentage of the overall banks' turnover; therefore firms cannot easily negotiate conditions; 2) Bank-firm relations are not exclusive: firms are not bounded by contracts to work with Italian banks (unlike Germans); therefore they shop around for the best conditions; 3) Italian banks do have a form of 'weak attraction' towards Italian firms abroad, based on bilingual services and easier credit rating. In sum, if the mother firm in Italy is Unicredit customer, the overseas daughter will have some advantages in working with the local Unicredit bank. In turn, there is a general interest from banking groups to support Italian firms abroad, to the extent to which successful daughter companies overseas support mother firms in Italy, therefore making the banks' customers in the homeland more solvable.

Instead, Italian services abroad are more closely connected with manufacturers. However, also in this case there is no bounding relation between services and manufacturers: services must win the support of manufacturers on the market. However, their work is indirectly supported by another set of power relations: especially small and medium manufacturers do not have enough financial power to negotiate directly with the national governments. Often, they also do not have enough human resources to acquire knowledge of the local spoken and unspoken norms governing business. Therefore, Italian legal and accountancy firms abroad can fill this gap by providing a friendly, Italian speaking service.

Out of these power relations, Italian internationalization produces an open system centered on cultural and language services. The possibility of access to easier credit evaluation, speak Italian when negotiating a loan, turn to a service firm able to support start up needs and provide legal and accountancy services that meet the needs of the Italian entrepreneur abroad does create a form of attraction between banks, services and manufacturers.. The data collected during the fieldwork research suggests that this culture-based relation can be quite effective: 43% of the firms surveyed have an exclusive relation with an Italian bank abroad; the figure increases to 67% when considering firms that use a mix of Italian and non Italian banks (see Table 3.4).[11] This system is specifically Italian. The interviewees identify the Germans as their main competitors, and highlight how the German system of internationalization is different:

> A German business going abroad is very rarely a micro-enterprise, like oftentimes happen with the Italians. In the end, we do it because of lack of structure, not because we are smarter. A real image of who we are can be captured just by looking at who comes in and out from the major airports in Eastern Europe. You will see swarms of Italian entrepreneurs, and maybe one German. All together, the Italians will have a turnover lower than the German. (Interview Italian chartered accountant, Boscolo & Partners Bucharest: 03-30-2006).

More in detail, the on average larger German firms have been preceded in Eastern Europe by the banks, which in turn provide a service to internationalization for German firms, in exchange of an exclusive bank-firm relation. The less structured Italian system is an outcome of the crisis of industrial districts: manufacturers were hit by increased competition first, and had to move away. In so doing, they exerted pressure on their local banks and local services in order to receive support overseas.

[11] However, further research needs to be done in order to collect the extensive quantitative data necessary to assess the effective strength of this attraction.

Chapter 3 - Bibliography

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Chapter 4
The role of Italian textile and clothing firms in the 'Timisoara miracle'

4.1 Overview

This chapter focuses on the city of Timisoara and its county (*judetul*) in Western Romania, which played a primary role in the internationalization of Italian manufacturers from North Eastern Italy since the mid 1990s, and still is one of the areas with the highest concentration of Italian foreign direct investments and sub-contracting relations in Eastern Europe (see Map 4.1 and Table 4.1). The chapter contextualizes the role of Italian textile and clothing firms in the present day Timisoara within a broader transformation of local institutions and governance. In so doing, it builds on the Gereffi and Meyer (2004) distinction between private and public forms of governance. They argue that the increasingly trans-national dimension of the economic activity is leading to the emergence of new forms of governance in both the public and the private sectors. Examples from the public sector include the linkage of labor and environmental issues to trade agreements; examples of private governance includes codes of conduct and other forms of corporate social responsibility (Gereffi and Meyer: 2004, p. 1). Specifically, this chapter looks at the ways in which new forms of public governance at local (city and regional) level and the private governance that Italian firms have established in the region surrounding Timisoara found venues of interaction in the context of a burgeoning 'economic miracle.'

Gereffi and Meyer pointed out that in Europe the European Union "appears to have found a way to address governance issues by creating deep (or thick) institutional structures at regional level that are difficult for other parts of the world to emulate" (ibid. p. 19). In Eastern Europe the EU-led harmonization of institutions is part and parcel of the deep institutional and social transformation following the collapse of the socialist regimes. Meyer (2001) argued that the post socialist transformation of Eastern Europe led to institutional frameworks only partially reformed, thus inconsistent and unstable. From the standpoint of multi-national companies, this condition reflected in high transaction costs in entering those markets. Meyer also focused on the importance of institution building (ibid. p. 364), arguing that the countries with the stronger emphasis on institution building are the most likely to attract heavier commitment from foreign investors. Over the 2000s Meyer's intuitions proved correct, and strong economic growth characterized South Eastern Europe. According to Tondl and Vuksic (2003) this was driven by foreign direct investments attracted by a combination of EU led institutional stabilization, highly qualified human resources and geographical proximity with the core of the European Union. Because of its large internal market, Romania plays a pivotal role in this process, attracting companies interested in the opportunities of a fast growing regional market (Cojanu: 2006). In Timisoara, the combination of these factors has led to an impressive economic growth, and the city is ranked second in Romania (after Bucharest) as for attractiveness of foreign direct investments (PricewaterhouseCoopers: 2004).

This chapter looks at the ways in which the local government of Timisoara was able to maximize the opportunities given by the European Union through the PHARE program, twinning programs with institutions in Western Europe and private funds from the Soros foundations in order to reform its own institutions. As a direct outcome, the city of Timisoara was able to attract a large amount of investment in the high tech sector. At the same time, Italian investors in the textile, clothing and other traditional sectors established themselves in following their own informal networks, without direct support from the local government. Specifically, the chapter shows the mechanisms that brought Italian textile and clothing investments in during the 1990s, and the processes of consolidation of their presence. Finally, it describes the ways in which Italians contributed to the institutional life and change of the city.

The chapter addresses the following research questions. What kind of interdependent set of decisions of the local government and foreign investors resulted in the 'economic miracle' of Timisoara? How did it evolve overtime? What kind of role was played by Italian textile and clothing firms? What kind of governance are Italian firms establishing?

4.2 The Timisoara Miracle

4.2.1 Timisoara as 'success story' of post-socialist economic transformation.

The city of Timisoara, with a population of 350,000, and the surrounding county (*Judetul* Timis: total population 662,209)[12] is both a 'success story' of post socialist economic restructuring following a neo-liberal economic model, and the area with the highest concentration of Italian-owned factories outside Italy (See Table 4.1, *Timisoara in figures*). Looking at the numbers, the following issues characterize the 'Timisoara miracle.' First of all, the economic structure of the city and region in the mid years 2000 is highly diversified, with a mix of local and foreign owned firms, representing a wide range of sectors

[12] Source: ADETIM, no date

of industrial production and trade. This led to a situation of full employment (2.41% of unemployment, against a national average for Romania of 6,2%), which reflects in an average wage level higher than the national mean (USD 320 per month instead of 307), but also in much higher cost structure (Consolato Generale d'Italia a Timisoara: 2006). This phenomenon entails also labor scarcity (ibid.), which can lead to conflicts among firms for the acquisition of labor (interviews).

Table 4.1: Timisoara in figures[13]

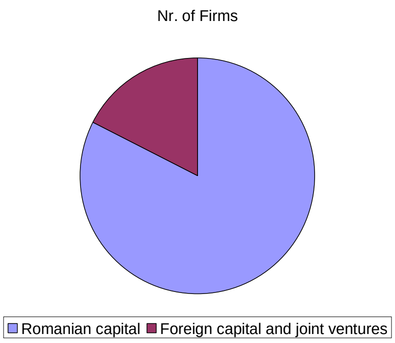
Sources: ADETIM, CCIAT and ICE

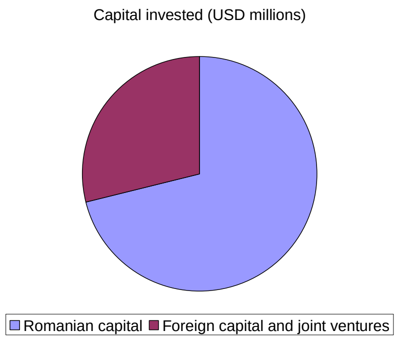
Socioeconomic data[14] (source: ICE)

	Population	Unemployment	Average monthly salary before taxes (2005
Romania	22,303,552	5.9%	USD 307
Timis County	687,377	2.4%	USD 320

Firms registered in Timis 1990 – 2005 by origin of the investment[15]

	Nr. of Firms	Capital invested (USD millions)
Romanian capital	32,322	1,494
Foreign capital and joint ventures	6,861	603
Total	39,183	2,097





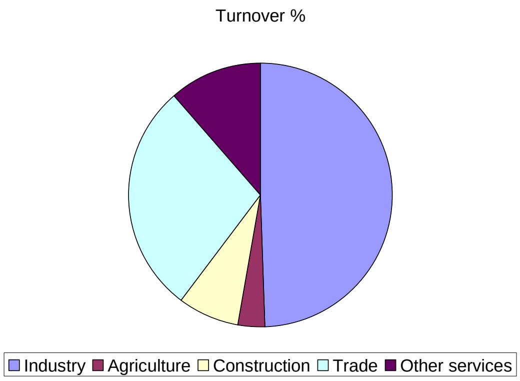
[13] The available data report all the firms that have been registered in Timis since 1990. Therefore, the actual number of firms active at any given moment will be different. On this issue, the president of the Timis branch of Unimpresa Romania stated that "We should not forget that in Romania there is the possibility to register micro-enterprises. Because they could benefit from a lower taxation, they were created with speculative means, to subdivide profits. Also, foreign citizens that wish to buy some buildings cannot buy the land. Thus, the trick is to constitute a micro enterprise to buy the land, and then the person buys the building." (Interview president, Unimpresa Romania, Timis branch: 04-03-06).

[14] Author elaboration of ICE data

[15] Author elaboration of CCIAT data

Turnover per economic sector in Timis county (data: 2004)[16]

	Industry	Agriculture	Construction	Trade	Other services
Turnover %	49.5%	3.3%	7.5%	28.4%	11,3%

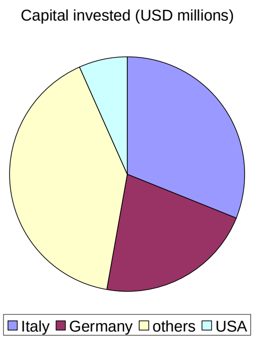


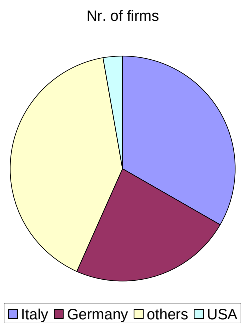
Foreign firms registered in Timis 1990-2005 – capital invested[17]

Rank	Country	Capital (USD millions)
1	Italy	188
2	Germany	130
3	Netherlands	89
4	USA	41

Foreign firms registered in Timis 1990-2005 – nr. of firms

Rank	Country	Nr. of firms
1	Italy	2,293
2	Germany	1,590
3	Austria	366
6	USA	194





[16] Author elaboration of ADETIM data

[17] Author elaboration of ICE data

In the fieldwork research, two local and two Timisoara-based Italian agencies active in development policies and promotion of Italian investments were interviewed. The local agencies are the Local Development and EU Integration Department of the City Hall of Timisoara and the Agency of Social and Economic Development of the Timis County (ADETIM). The Italian agencies are *Antenna Veneto*, based in the Chambers of Commerce, Industry and Agriculture of Timisoara (CCIAT) and the Commercial Office in the Italian Consulate of Timisoara. All four agencies advertise in similar ways the strengths of the economy of Timisoara. First, In interviews and brochures all mentioned the strategic location of the city, with “ten European capitals located in a radius of five hundred kilometers from Timisoara.” (Interview counselor, CCIAT, 04-06-07). Second, they highlighted the development of the agricultural sector and of a rapidly growing, low polluting and diversified manufacturing. Third, each mentioned the high level of education, due to the presence of a dense network of public and private universities. Fourth, Pricewaterhouse: 2004 highlighted that the Western region of Romania is the second after Bucharest area as for attractiveness of foreign direct investment, because of the above mentioned reasons, and because of railway density, telephony activity and developed health system.

Behind this official portrait of the economy of Timisoara there is a shared neo-liberal ideology in the local administration and Italian agencies as well. This view can be summarized as follows: foreign investments are to be attracted, in order to inject capital and technology in the local economy, and in order to ‘learn capitalism’ from them. Second, in order to break away from the communist past, state owned facilities have to be privatized, and local administrations have to be re-structured and reformed following the example of ‘mature’ capitalist countries. Because of proximity, and the funds available from the European Union, Western European models are the most closely followed.

4.2.2 Local policies towards foreign investments.

This attitude towards foreign investors emerged repeatedly in the interviews. The Commercial office of the Italian consulate employs a local trade analyst, whose view of the role of Italian investors in the local economy is as follows:

> For a long time we tried to develop in this area the ‘Veneto miracle’ of the small and medium enterprises, and to encourage employees to create small businesses that support larger companies. However, it is difficult, because it needed thirty years to develop the Veneto system; instead here we wanted to do everything in a short time, which clearly was not possible. …. I think we will develop this model much quicker than in Veneto, but we will need a few years. This is a model for us: it was the only one we saw, because entrepreneurs from Veneto were the first to come, and arrived in large numbers. Instead, as the President of the County said, now we must accept the fact that Italian and Romanian companies are developing in parallel way. It is not anymore, as it was the case a few years ago, of Italian businesses bringing wealth, and that the others had to work for them to gain access to part of this wealth. No, we work together, and, if we work well, we have mutual advantage (interview Romanian trade analyst: 04-10-2006)

In the interviews with local government’s representatives, openness towards the needs of foreign investors translates in an easy access to the city’s administration, but also in aggressive promotional campaigns organized by the administration in order to attract businesses. High level officials at City Hall and ADETIM describe the situation as follows:

> The city assumed the role of facilitator of businesses. In the ‘Development Concept of the City of Timisoara’ the first direction is to create a moral and friendly oriented business environment. In the year 2000 we said: ‘no corruption – or reduce corruption’ and ‘friendly administrative environment.’ To give you an example, our mayor meets all the investors wishing to come to Timisoara; all the companies located here have an open door to the mayor office. If a company calls me and asks to meet the mayor tomorrow he will do its best to have the meeting, even if his schedule is very charged. Also, the mayor makes an aggressive economic promotion of the city geared towards investors. He was – and still is – participating in international conferences and international fairs, presenting the city and trying to convince businesses that Timisoara is the best place to invest. My department has the duty to ensure the

> contact with all investors and potential investors. We developed several projects, like industrial parks, software businesses incubator, technological park and other big projects to attract investors. We changed procedures in order to reduce the bureaucracy and speed up business start up processes. For example, the maximum time to obtain a building approval is thirty days; we have a policy that for foreign investors the maximum time must be fifteen days, half of that. (Interview Head of Local Development and EU integration, City Hall of Timisoara: 04-14-2006).

> Italian firms come to us to have information on the Timis country. (Interview project manager, ADETIM: 04-12-2006).

However, the openness of the local administration to the needs of foreign investors tells only one part of the story of the ways in which foreign businesses are accepted and integrated in the local environment. Local administrators and trade unionists do not welcome foreign investors uncritically, but they decide their support looking at the respect of the local rules, stability of the investment and the requirement of bringing something positive to the local economy. The distinction is often made in the moral terms of ‘serious’ and ‘non serious’ investors. The president of the Timisoara based National Federation of Trade Unions in the Textile Industry (F.N.S.I.U) describes foreign investors in the textile and clothing sector as follows:

> Among foreign companies, there are serious investors and non serious investors. Last week I was at a conference with Italian trade unions, and I see they have the same problems. Unserious Italian investors have no social conditions in factories, they try to exploit, paying less than minimum wage, give lots of problems.
> Usually, serious companies have around one thousand workers, pay their debts and taxes, and invest in the social structure. Instead, unserious companies have 50-150 workers, the conditions are very low, do not respect working and payment conditions, and give us lots of problems. (Interview president, F.N.S.I.U: 04-11-2006).

This distinction between ‘serious’ and ‘non serious’ investors apply to the Italians, and it is somewhat related to the historical progression from the short term, low capital investments of the early 1990s to the heavier commitment of recent years:

> After 1989 [Italian] entrepreneurs began to come. Obviously, the pioneers were people who wanted to make big businesses with little money. Thus, the early 1990s contributed to the bad imagine of Italians, because any kind of people came, also those who gave us problems. With time, real and serious enterprises, which wanted to make a serious and maybe long term investment, came (interview Romanian trade analyst: 04-10-2006).

4.2.3 The transformation of the local economy: 'Timisoara exceptionalism' and the support of neo-liberal reforms.

From the standpoint of the transformation of the local institutions, post-communist transformation meant a radical shift from a rigid, top-down bureaucracy to a set of fairly autonomous local institutions in network relations with each other and with Western European institutions. Two factors played a leading role in this transformation: a) a set of peculiar historical and socio economic conditions that pushed the local elites to support the adoption of a capitalist system earlier than in other areas of Romania – in this work they will be referred to henceforth in terms of 'Timisoara exceptionalism;' and b) the large amount of funds available to support the Eastern European transition to market economy that the local administration was able to attract.

Timisoara exceptionalism is rooted in a cultural and political tension between the city and the national government in Bucharest during the years of Ceausescu's communist rule, which resulted in the prominent role of Timisoara in overthrowing the communist regime (Mihas: 1997). This tension arises from being a richer than the national average, peripheral and culturally diverse province, and therefore being perceived from the centre as a threat to its homogenizing and centralizing policies. Echoes of this tension still emerge in the accounts of the early phases of transition:

> The headquarter [of this Union] is in Timisoara. It was founded in 1992, and Timisoara was preferred to Bucharest. It was the first Union with headquarter outside the capital.
> Q. Why Timisoara and not Bucharest?
> A. When it was founded, the first organization was from Timisoara. …. I had, and still have, doubts about Bucharest, so I told my colleagues that if we were to move to Bucharest I would quit this job. For you, to understand better this choice, I tell that in the center and western Romania people are more determined, they respect the work given, they are more serious. At that time, this wasn't the case in Bucharest.…This difference was made by Ceausescu, and since then there is a struggle between Timis and Bucharest, but now things go better….
> Before 1989… There was scarcity of goods, but we had money. Here, in the West side of the country, we were better off, because we could go to Serbia and Hungary to buy stuff. Also, in Timis County there was the largest production of pig meat in the country. This is a reason why Ceausescu didn't like us, because this area has a more efficient mentality than the rest of the country. (Interview president, F.N.S.I.U: 04-11-2006).

> The revolution started here. Here people wanted the market economy…
> Among the mechanisms of recovery, the mentality of the population is our greatest asset: pro free market, pro competition, hard working. People have a material culture, they are proud to have. For this reason they are hard working….
> Another major advantage of Timisoara is the geographical location. We are near the border, 60 km away from Hungary and 40 km away from Serbia, and access to all means of transport and communication connections with Europe. (Interview Head of Local Development and EU integration, City Hall of Timisoara: 04-14-2006).

In sum, 'Timisoara exceptionalism' can be summarized as a privileged geographical location, plus the political will to get rid of the past centralized control of the communist party and Romanian State. In this context, pro-free market reforms were widely accepted because they provided the mean to reach this autonomy. This meant a deeper implementation of industrial restructuring:

> Also, the economy of Timisoara has been traditionally rich. This was one of the best industrial areas. At the same time, here the reforms started earlier. It was not a show-off process; here people were really committed to reforms. It was not titles on newspapers, or political wishes, here companies were restructured for real and reforms were implemented faster than elsewhere. (Interview Head of Local Development and EU integration, City Hall of Timisoara: 04-14-2006).

It also meant that the high social costs involved in neo-liberal economic reforms did not find as much opposition as they could, which is reflected in the elections patterns, favoring right-wing parties since the beginning of transition:

> Of course, there were lots of problems in the beginning. However, we saw results quickly. Another one: the city was always led by a right wing party, and I think this is important for the reforms. I'm sure it will come a day when the left will be necessary. Speaking as an individual, the left wing policies do have advantages. But talking about the 'general economy' and especially about the passage from an 'extreme left' economy to a free market, it is necessary to have a strong wish, and not to concentrate so much on the social needs of the population. You need to have a long vision.
> …. We did not need political pressure to implement the plan; we just needed to raise the pride of people
> Also, we did not have large protests here. People accepted the leaders, and accepted to be lead, and this is positive, because the measure we described had some social costs for the population, and it is a big advantage to have their support in the reforms. (Interview Head of Local Development and EU integration, City Hall of Timisoara: 04-14-2006).

Timisoara exceptionalism guaranteed popular support and faster implementation of the socially costly neo-liberal reforms such as laying off people from oversized state owned enterprises, keeping tax levels low (therefore, reducing the development of infrastructures) and curbing wages growth. Officers in the local government are well aware of the prices that the local population had to pay in order to implement these reforms:

> In order to reform, the first measure we had to take was to reduce firms' size, because SMEs have the huge advantage of being flexible and easy to change. This was the main disadvantage for the population, because there had been a period of time in which unemployment increased a lot. Also, to attract foreign investments – you know, one of the main reasons why they are coming is because of the low salaries. Therefore we encouraged salaries to remain low. Also, we had to accommodate taxes to the low salaries. This was a big disadvantage for the local government; we just did not have the money to re-habilitate the infrastructure. In all former communist countries, and especially Romania, all infrastructures are *kaput*, at the limits. So we had lots of needs and no financial resources. ….. As you can see, the city is a mess, and of course, the population is not happy with it. All these measures, including reforming the companies and attracting foreign investors are not popular. So we needed to explain things to the population, to increase communication. We increased transparency in order to have people as allies and not as opponents, because reforms are not possible if the population does not want them. (Interview Head of Local Development and EU integration, City Hall of Timisoara: 04-14-2006).

4.2.4 The transformation of the local institutions: the role of the financial support from the European Union and other international donors.

However, these reforms alone are not clearly sufficient to explain the internal changes in local government and its economic policies. At present, the economic policy at the city and county levels are the result of a tight interconnection between the City Hall and a set of other institutions. The most important of these are the Chamber of Commerce (CCIAT) and two development agencies: ADETIM – which works at city and county level and ADRVEST, at regional level (Pislaru, D. *Interview with OECD*), and the co-operation is built on the basis of a precise document: the Strategic Development Concept for the City of Timisoara. Except for the City Hall, all these institutions have been constituted after 1989, with a small budget from the State. They rely on grants from international donors for their operations and very existence. Therefore, the availability of funds, in the form of grant schemes – and the ability of the local elites to capture them - shaped the change in the structure of the city's administration.

Because of the structure of the grants from the EU and other donors, which privilege projects with a component of international co-operation, the above mentioned agencies are active both in developing the 'transnational institutional chains' described in chapter 2 and in promoting the development of skills in grant writing for the local administrations of Timisoara and the neighboring cities and towns, which is an increasingly important source of funds for local administrations throughout Eastern Europe. A closer look at ADETIM can give a new light on the extent, and the ways, in which Timisoara local government changed in response to the joint stimuli of the shift to a market economy and enlargement of the European Union.

ADETIM[18] (www.adetim.ro), the "Agency for the Economic Development of Timis" was founded in 1995. It was itself part of a project funded by the European Union and a German public agency. German aid was fundamental to set up the agency:

> ADETIM was established in 1995; it was part of an EU sponsored project that was co-financed by the regional development agency of Westphalia (Germany). The Germans brought some logistics, and trained ADETIM personnel, and we did with them our early projects in 1996 and 1997. Germans put a lot of money in this agency (Interview project manager, ADETIM: 04-12-06).

The initial duty of its nineteen persons staff was to prepare grants; over the years, they took the task of providing information about the opportunities of the county to potential investors and developed training courses on grant writing for public administrators of the county's towns. At the moment, this is a unique system in Western Romania:

> We have training programs to prepare people in the local administration to identify grant opportunities from the EU and to prepare the applications... They work in close contact with us, we prepare projects together. By now, there are such professionals in the 70% of the towns in the county. In this moment, this system is unique of Timis; and we are working to extend it to the neighboring counties as well (Interview project manager, ADETIM: 04-12-06).

A closer look at this process offers some understanding of the way in which the enlargement of the EU functions as a political project to stabilize Eastern Europe within a capitalist framework:

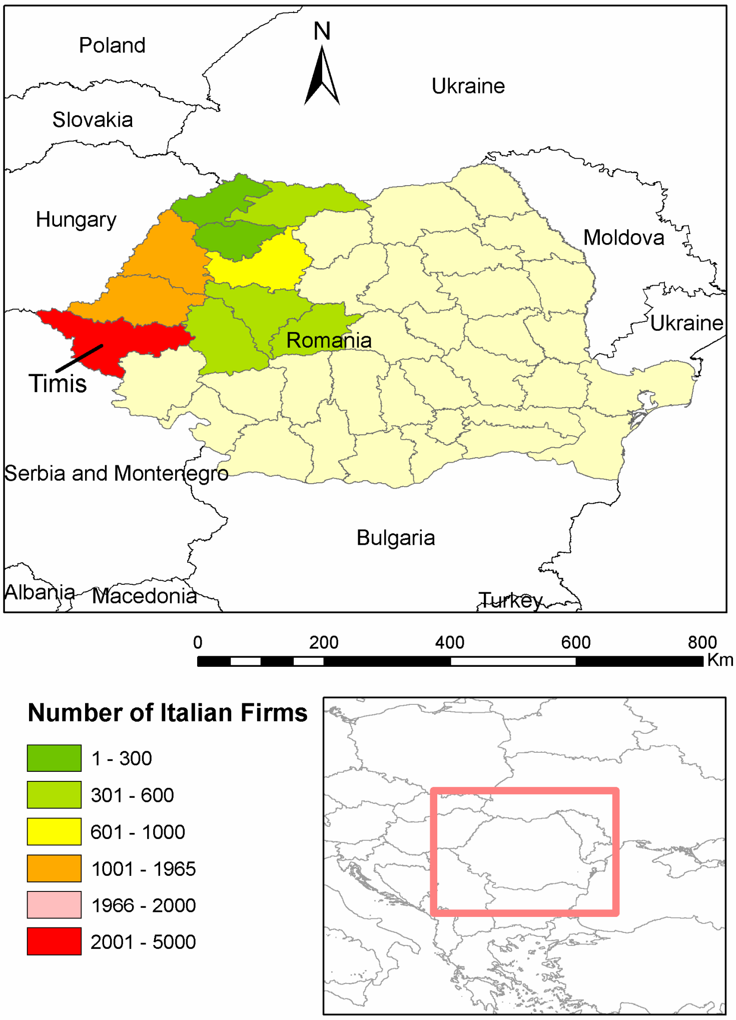
> Q. How much did local institutions change, as consequence of the international co-operation you described?
> A. There were some changes, but not too big. The change is general, because EU membership requires the adoption of the EU legislation. This process starts from the central government. They made several twinning projects [with institutional partners from the EU], but this started in Bucharest. We had some of it too, because of the co-operation we had with foreign local institutions. … Now we are starting projects on environment protection. We have a new law, according to which we need to integrate ecologically sensitive areas in the land use planning.

[18] The agency has a website, www.adetim.ro, but it is only in Romanian language

> Because of this we are developing a twinning with a French agency for the protection of the environment.
> Q. How does a twinning work?
> A. They come, provide the organizational structure of the institution, some regulations and management methods. Together with the twinning there are also economic links between the two countries.
> Q. Does this mean that official missions were organized to let entrepreneurs from the two countries meet?
> A. Yes. Besides this, things happen unofficially: through twinning projects information is collected, and then given to the chambers of commerce, or they simply flow through informal networks (Interview project manager, ADETIM: 04-12-06).

This conversation can be better understood considering that, notwithstanding the sweeping changes imposed by the collapse of the Communist bloc, in most cases the basic structure, and the personnel, of the State bureaucracies across the Eastern European countries did not change dramatically (Szelenyi and Szelenyi: 1995). This statement has found supporting evidence during this fieldwork research: of the eighteen state officials interviewed, all the senior officials were in the State administration before 1989. In this condition, in Timisoara the grant schemes of the European Union had the effect of leaving in place the old bureaucracy, and at the same time providing the resources to establish new agencies, or new departments into existing ones. ADETIM is an example of a brand new agency, in which the organizational structure and management is being modeled upon the German partner that provided part of the initial funds. 'Local Development and EU Integration' is an example of a department of the City Hall established thanks to a grant from the Soros Foundation, which provided the funds necessary to prepare a strategy concept for the county's economic development (Interview Head of Local Development and EU integration, City Hall of Timisoara: 04-14-2006). At the same time, the practice to obtain funding on a grants basis, which involve co-operation with foreign partners, has the side-effect of producing information about the region and its opportunities, that can circulate along formal and informal networks until reaching potential investors.

MAP 4.1: Concentration of Italian investments in Western Romania



4.3 Pattern of the Italian investments in Timisoara; role of the clothing firms

4.3.1 Logic of firms vs. logic of institutions

All the above mentioned factors alone do not explain either the leading position of Italian investments in the economy of Timis county (see Table 4.1), or the way in which Timisoara was able to attract an unusually high number of Italian firms when compared with other areas of Eastern Europe. For example, data from the Institute of Foreign Trade (ICE) state that 2,291 Italian firms had been set up in Timis County from 1991 to 2005; the same source indicates that there are around 300 Italian firms active in the whole country of Slovakia (see Consolato Generale d'Italia a Timisoara: 2006 for the data on Romania and ICE: electronic document for the data on Slovakia). In geographical literature, an analysis of the reasons why the analysis of economic policies alone cannot account for the behaviors and performances of the private sector can be found in David Harvey (2003). In the *New Imperialism*, Harvey analyzes 'the dialectical relationship between the politics of state and empire on the one hand and the molecular movements of capital accumulation in space and time on the other" (Harvey: 2003, p. 89). At the root of Harvey's argument is that State power gains its strength from territorialized hierarchies, while capitalists gains in an un-stoppable, dynamic movement of capital throughout spaces, that gets incessantly accumulated and fixed in space, to be later de-invested and shifted towards other locations as consequence of economic crises and the consequent emergence of new opportunities for lower costs and/or higher profits elsewhere. Looking at Italian investments in Timisoara under Harvey's light, it can be interpreted as local authorities being very smart in supporting a process that was already happening on its own, but they did not – and could not – create the process by themselves. In other words, the ultimate decision to invest belongs to the capitalist only, regardless of how friendly and helpful a local administrator or a local partner can be. Italian entrepreneurs followed their own profit seeking logic, channels of information, social circles, opportunities that brought them to Timisoara in large numbers. The following sections discuss these issues, showing how national level trends for the whole Romania and local issues in Timisoara shaped the ways in which Italian enterprises embedded themselves in Timis.

4.3.2 The influence of national and supra-national trends on the Italian investments in Timisoara

First of all, the investments in Timisoara follow a broader pattern characterizing the whole country of Romania, which in turn is intimately connected with the broader pattern described in the previous chapter. According to the General Secretary of the Italian Chamber of Commerce in Romania, three main steps in the evolution of the economic relations between Italy and Romania can be identified. Before 1989, commercial relations were already in place:

> There have been three main periods. First of all, even before 1989 there was an activity of Italian businesses in Romania. The Italian-Romanian bank exists since 1982, because there was the necessity to support trade, mainly in the meat and textile sectors. Also, the Italian group Ansaldo built a nuclear power plant here (Interview General Secretary, Italian Chamber of Commerce in Romania: 03-22-06)

After 1989, small and medium enterprises from the North East of Italy ‘discovered’ Romania, and concentrated their activity in the region of Timis and neighboring counties. This initial step was characterized mostly by sub-contracting relations with local firms in the shoemaking and apparel sector. Among the factors pulling towards Timis, opinion leaders mention cheap labor, a network of local firms with whom establishing contracting relations, geographical proximity with northern Italy and the possibility to reach the area traveling by car, low language barrier (both Italian and Romanian are Romance languages) and 'similar mentality.' A third step consisted in Italian manufacturers establishing factories in the area, followed by service firms and banks. Currently, the fourth step is directly related to Romania's economic growth, large national market[19] and political stability. Large companies from a wide array of sectors are investing in Romania, shifting the quality of the investment: from production-focused, OPT based to investments aimed at developing and selling on the local market.

This last passage is entailing a transformation of both the local market and the geographical distribution of Italian firms. Growing wages, migrant remittances, policies from the national bank are pushing towards the increase of consumption:

> It is a little like our [Italian] stories of the 1950s, in which the migrants came back to the home towns and bought washing machines, and everyone else in the village wanted it, because it was trendy and showed success. Here the situation is in a way similar, and lately consumption in Romania is growing. In this context, Italians have an advantage (but I don't know how long it will last), which is the good name of the "made in Italy." …
> In Romania in the last couple of years there has been an almost foolish policy of credits for consumption, thanks to new rules established by the National Bank. It was possible to access to micro-credits to buy a TV, the cell phone, etc., and this policy was widely used by consumers, much more than in Italy. Now they are becoming more restrictive, but still any company selling house appliances has its own credit division (Interview General Secretary, Italian Chamber of Commerce in Romania: 03-22-06.

> The Romanian GDP is growing rapidly. However, the growth is driven by trade more than by production. A solid backbone of local enterprises is still lacking. The development is being pushed by trade, there is not much of local production (Interview president, Bucharest Branch, Unimpresa: 03-31-06)

[19] With a population of 22 million, Romania is the largest country in South Eastern Europe.

For Italian firms, this meant a change in the business environment. Particularly, a precise set of conditions reduced the profit margins for the light manufacturers (especially in the clothing and shoemaking sector) who moved to Western Romania in the 1990s to set up factories working in OPT trade. First of all, as stated above, the economic development of Timis pushed wages to grow higher than the national average. Second, prices of energy and utilities are growing. Third, the national bank policy led to the appreciation of the local currency over the Euro. Given that the OPT contracts are signed in Euros, this entailed a net loss for manufacturers:

> In 2004, the cost of 1 Euro was 4.1 New Lei; in 2005 the average was 3.6 New Lei for 1 Euro. The subcontractors, who have contracts in Euros with the Italian clients, lost 15% of their income just because of the exchange rate (Interview general secretary, Italian Chamber of Commerce in Romania: 03-22-06).

> [Because of the exchange rate] my earnings are fifteen – twenty thousand euros per month lower than they used to be… The advantages are coming to an end: suppliers raise prices, clients don't. (Interview entrepreneur, Italian clothing firm in Timisoara: 04-11-06)

> OPT still exist, but since the 1990s peculiar problems emerged for those working with OPT. 1) wage increase, which was due, because they were extremely low; 2) increase in the cost of energy, services, and everything linked with manufacturing; 3) appreciation of the Lei over the Euro, because contracts are denominated in Euros. This last point is convincing many businesses either to close or to move elsewhere (interview president, Timis branch, Unimpresa Romania: 04-03-06).

All the interviewees in the clothing sectors declared that this change of exchange rate has had a much stronger impact on their profits than the expiration of the multi-fiber agreement (MFA) on January 1st 2005. The MFA had regulated the world trade in textile and apparel for twenty years (1974-1994) and had been progressively phased out from 1995 to 2005 integrating the textile and clothing industries into the normal WTO rules (WTO: electronic document). This finding about the relevance of exchange rates adds a further layer of analysis to the changes in the textile and clothing value chains, suggesting that changes in trade regime alone are a significant, but not the exclusive, driver in the changes of the geography and organization of the textile and clothing value chains (see Weil et al.: 2004, Knappe: 2004, Gereffi and Memedovic: 2004 for a discussion of the emerging sourcing patterns in the textile and clothing global value chains). Particularly, Italian producers and Romanian subcontractors consider to be shielded from Chinese competition because of the higher quality of their products. The last factor impacting negatively Italian manufacturers, especially in the Timis area is their excessive concentration, which led to conflicts for hiring qualified labor force:

> Timisoara has 350,000 inhabitants, and 2,000 Italian firms, so where do businesses find workers? At any moment can come a competitor, stand in front of my factory offering 100 thousand lei more to let my workers go to work for him. In these conditions, it is difficult to co-exist, to find specialized labor force (Interview General Secretary, Italian Chamber of Commerce in Romania: 03-22-06).

The phenomena described above for Romania follow closely the broader patterns described in the previous chapter, of a spontaneous flow of Italian economic activity in Eastern Europe beginning with low capital, production oriented investments (subcontracting relations in OPT regime followed by the establishment of Italian owned factories), followed by banks and services and finally by heavier, market oriented investments that accompanied the economic stabilization, GDP growth and wage increases in the whole area.

As elsewhere, but more intensively than in other Eastern European countries because of the higher number of Italian firms, by the early 2000s both Italian institutions and firms began to raise the issue of the governance of the Italian economic involvement abroad. The pressing issue faced by public institutions and the most far seeing entrepreneurs is to give rationality and contractual power against the local government to Italian firms abroad.

Mirroring the condition of the industrial districts at home, there is a wide spread understanding that small Italian firms can have weight if they act as aggregates. In Romania, this issue became pressing because of the competition with other foreign groups, which came with fewer, but larger investments:

> I noticed that Italians do not act as a system, unfortunately. They act more as individuals. Germans, albeit they are fewer than the Italians are more used to act systematically. They meet; they have a German Economic Forum with the representatives of all large German businesses in this area. They are better organized at local level (interview Romanian trade analyst: 04-10-2006).
>
> The strategy [of the Italian embassy in Romania] is to achieve a better organized, less spontaneous, Italian economic activity (interview chief commercial officer, Italian embassy in Romania: 03-31-06)

Unlike Italian industrial districts, firms abroad lack that social connectivity given by the local and civic identity widely described in the industrial districts literature (Becattini et al.: 2003), which allows districts' firms to act as a system even when formal consortia and/or interfirm agreements are not established. All across the fieldwork area, the response to this need to achieve a more coherent system took two forms. From the standpoint of institutions, the Italian parliament has been discussing new laws aimed at rationalizing the support to the activity of Italian firms abroad (CIM: electronic document). In practice, public agencies supporting Italian firms abroad and entrepreneurial associations are encouraged to share the same buildings and act in synergy. Such initiatives have been implemented throughout Eastern Europe: for example, in Bulgaria the Institute for Foreign Trade, the Association of Italian Entrepreneurs and the representatives one Italian regional government and one Italian chamber of commerce were re-located within the embassy building (Aleksova: 2005). This and other similar initiatives are attempts to address an issue that often rose from the grassroots of the entrepreneurs:

> Q. What is your impression of the activity of Italian institutions abroad?
> A. The most important of them are the Embassy, the Institute for Foreign Trade, and the Italian Chambers of Commerce abroad. Italy presents itself abroad in an unclear manner; there is a confusion of too many independent and un-coordinated offices. Entrepreneurs often feel abandoned by their institutions. (Interview Italian service firms: November 2005).

> I do not have a good opinion of our presence in Romania, because as usual, we were dispersed, with no direction, with no support from institutions, and we came this way. (Interview Italian entrepreneur in Timisoara: 04-10-06).

From the standpoint of firms, either Italian chambers of commerce abroad, or associations of Italian firms, or both have been constituted. Even though chambers of commerce abroad and entrepreneurial associations may have slightly different tasks, which vary country by country, their fundamental duties are to protect the interest of Italian firms in the host country, disseminate information useful to firms and provide entrepreneurs with the possibility of meeting and networking. These are private associations, membership is not mandatory. Therefore, the potential for the success of this project of harmonization of the Italian presence abroad in significant part depends upon the ability of chambers of commerce and entrepreneurial associations' to convince a large enough share of the Italian firms to associate, which may sometimes be difficult for cultural reasons:

> There are entrepreneurs who believe in it, there are entrepreneurs who join because of friendship ties, other who boycott associations. I think that more responsible entrepreneurs believe in associations, because they understand that they have to unite to have weight. However, the Italian entrepreneur is by definition a loner, so he or she runs alone easily. However, Unimpresa has around one hundred members only in Timisoara, that's a good sign (Interview Italian accountant, Boscolo & Partners Timisoara: 04-05-06)

> We want to do a bit of lobbying. Other foreigners do it more easily than we do. [For us is harder, because] Italians have a good and bad individualism at the same time: it is good within the firm, because it develops intelligence and innovation; it is bad when it comes to problems and issues external to the firm (Interview president, Bucharest branch, Unimpresa Romania: 03-31-06).

In this overall situation, the association of Italian firms in Romania, Unimpresa Romania, stands out among other similar associations in other Eastern European countries. First of all, reflecting the outstanding importance of Romania in the landscape of Italian investments abroad, it has been significantly supported by the most important national firms associations in Italy (Confindustria and Confcommercio). Partly for this reason, it has the largest number of members of any association of its kind: around 700 firms, among which the most important Italian investments are included. This is not a large number, considering that around 18,000 Italian firms are registered in Romania and an imprecise number, amounting in the order of thousands, are active (Interview Italian consultant in Bucharest: 03-31-06). However, it is large enough that the Romanian government officially recognized Unimpresa as one of the official representatives of businesses in the negotiations between firms, government and trade unions. Finally, unlike other similar associations, which have a very light organization, Unimpresa has a central office in Bucharest and local offices in the regions with the highest concentration of Italian firms. Although it is too soon to assess the success of the Italian State initiatives to improve the synergy among institutions abroad and Unimpresa (the debates on the new legislation began in 2005, Unimpresa in its current form started in 2004), the two initiatives show the consolidation of the Italian economic presence in Romania, and the willingness to establish a more coherent system for Italian firms abroad.

4.3.3 The factors leading Italian apparel producers to Timisoara

These general trends played out in very specific ways in Timis, particularly in the clothing industry. Having been among the first industries to outsource and then to invest in

Timisoara, the study of apparel manufacturers can shed light on the ways in which the whole process of Italian internationalization in Timis played itself out.

Especially in the early waves, apparel manufacturers established relationships and invested in Timis acting 'below the radar' of the institutional support. Until the 2000s, there was no Italian institutional presence in Timisoara. Firms should have taken a long detour to Bucharest to receive support from the Institute for Foreign Trade, and they preferred go directly to Timis following their own channels:

> Early visits from Italian entrepreneurs [in Timisoara] happened with no institutional support, because of the will of entrepreneurs, not of the institutions. ICE has been in Bucharest for more than thirty years. …. Thus, there was an institutional presence of the Italian government at national level, but it was not much used by entrepreneurs (interview Romanian trade analyst: 04-10-2006).

From the standpoint of local institutions, the support of manufacturers in the traditional sectors of the economy is not a priority. Instead, their foreign investment oriented economic policy focused mostly on high tech industries:

> In our concept, looking at our natural resources, to the skills of the population, we decided that the best focus for us would be software and high tech. Timisoara was the first city in Romania producing computers. So we had tradition here, but not a lot if compared with Germany. So, we decided that there are three branches we must focus on: software, high tech, automotive industries. None of them was developed enough. Because of this, we based our development on foreign investments. We encouraged FDI in these fields. Of course, we focused on large companies. We paid Alcatel, Continental, and Siemens to come here. We did so because we knew they would have attracted their induced activities. …. Attracting one big company you actually attract three or four others, plus the services. Also, foreign companies at least in the beginning have foreign managers, who need housing, several services, and entertainment. In this way we had a chain development involving many sectors of the city's economy. Therefore, foreign investments had the main role in developing the region... They are telling that they found the same quality for half the price (Interview Head of Local Development and EU integration, City Hall of Timisoara: 04-14-2006).

Therefore, the Italian apparel manufacturers are not receiving direct financial support from the local authorities, even thought they recognize that the combination of new high tech sectors with traditional sectors benefits the economic diversity of the city:

> Q. Italian investments are important too…
> A. That was in the traditional sector. Traditionally, mostly the light industry, apparel and shoemaking, was developed in Timisoara. This is why in this moment the economy is really diverse, because traditional branches still exist, but new are being developed. We have also more traditional development in the light industries (textile and shoemaking). Italian investments are mostly SMEs in the light industry, which are engaged in OPT trade. Instead Germans are mostly large companies. Because of Chinese competition and wage growth in Timisoara, we know we will loose part of the light industry (interview Head of Local Development and EU integration, City Hall of Timisoara: 04-14-2006).

But what were the actual mechanisms leading Italian clothing firms to Timisoara? Evidence from the fieldwork research suggests that locally based contacts with people in the same – or close – profession heavily influenced the choice of internationalizing in the area. Eleven firms plus the local service firm in the IC & Partners Group in Timisoara, and surrounding area (Timis and Arad counties) were interviewed. Seven were Italian apparel producers (i.e., Romanian firms with 100% Italian capital), two were Romanian subcontractors working mostly for Italian firms, one was an Italian-owned logistics firm managing customs and transports between Italy and Romania, and one was a non-textile industrial producer, president of the local branch of Unimpresa. IC & Partners provided the initial contacts that were further extended in a snowball process. Overall, the findings stress the importance of both formal (pre-existing subcontracting relation) and informal (friendship and kinship) interpersonal relationships of trust in driving the investments, as argued in a vast number of studies on business to business relations (for an overview, see Blois: 1999). Table 4.2 shows the importance of local people in the decision making process of establishing the Italian-owned firm stands out: altogether, a pre-existing subcontracting relation and a trust relation with a local person, accounts for 55% of the responses. It also suggests that the pre-existing tradition in the clothing sector was important in setting in motion the process of Italian internationalization, because 33% of the Italian owned firms interviewed were established following a pre-existing contracting relation. This finding suggests that the value chains are not only sources of new forms of governance (Gereffi et al. 2005) or drivers of product upgrading for manufacturers (Schmitz: 1998; Tokatli: 1997), but also privileged channels of information for the establishment of Italian apparel foreign direct investment.

Table 4.2: Reasons for establishing a firm in Timisoara or surrounding areas

Overview
Eleven firms were interviewed in Timisoara and surrounding areas. Seven were Italian owned apparel industries, two Italian owned non apparel (logistics and the Unimpresa president), and two Romanian subcontractors for an Italian firms. Italian firms were asked what led them to choose Timisoara, instead of other areas in Romania or other countries.

I had a relative in Timisoara	I had a subcontracting relation here, and I needed to expand	Another Italian entrepreneur helped to establish the firm	My local contact is from Timisoara	No answer	Total
1	3	1	2	2	9
11%	33%	11%	22%	22%	100%

'No answer' refers to situation in which the interview was conducted with local managers, who were employed after the firms were established, instead of the Italian entrepreneurs.
In the sample, the importance of local people in the decision making process of establishing the Italian-owned firm stands out: altogether, a pre-existing subcontracting relation and a trust relation with a local person, accounts for 55% of the responses.

4.3.4 The model of internationalization of Italian apparel firms in Timisoara

Besides highlighting the importance of informal, intra-professional networks in setting in motion the Italian economic activity in Timisoara, the interviews with firms in the clothing sector allow to deepen the understanding of the structure of the Italian internationalization. Particularly, so far it has been described as a succession from low tech, low capital, and production-oriented firms to higher tech, higher capital and market oriented firms. However, clothing firms show that this process did not entail necessarily only a shift in industrial sector, i.e. clothing firms closing down and leaving space to higher tech firms. Instead, Timisoara witnessed a consolidation of clothing firms, which followed the same progression from low to higher level of sophistication. The process consisted in the following elements.

First of all – widely cited by the interviewees – the initial internationalization of producers has been followed, especially since the 2000s, by the other components of the value chain as, for example, die works, sewing machines distributors, platforms,[20] embroidery workshops:

> When I first came in 1993 Romania was very different. Until 1995 it was physically difficult to reach. Producers came first, and later were followed by their suppliers of cloth, yarn, zippers, buttons, and ribbons. Then the representatives of sewing machine manufacturers established commercial offices and technical support. The whole value chain is trying to move here, with one important exception: the textile industry. Romanian textile went bankrupt, and now it is imported from Turkey, Italy, and East Asia (Interview Italian entrepreneur in Timisoara: 04-11-06)

As in other sectors of the economy, the establishment of large multi-nationals (Benetton being the most famous) has been a very powerful pull factor in the geographical shift of the value chain. Particularly, Benetton pushed its own subcontractors to move from Italy to locations in Eastern Europe, among which Timisoara. In the fieldwork research it emerged that those who came following a multi-national were consistently larger and better

[20] A platform is a small firm as far number of employees – ten or fifteen – whose work is to co-ordinate the activity of subcontractors working for a larger own-brand manufacturer.

endowed as far capital and technology when compared with other subcontractors, and especially with the locals. The difference may be very strong: they employ in the order of hundreds, while the locals have less than fifty employees, and are much less endowed as far capital and technology. The two Benetton subcontractors interviewed showed many of the characteristics of a buyer-driven value chain (Bair and Gereffi: 2004): Benetton provide them with large orders and technical assistance; however, they are price takers and in condition of dependence on Benetton orders, even when they have their own brand production besides the subcontracting activity. However, these are medium to large producers, who created a large enough demand that other elements of the value chain to follow.

Table 4.3 highlights this process for the firms interviewed. Those who started earlier were mostly subcontractors, independent firms that produce apparel in OPT regime for own brand manufacturers located in Italy. The smaller firms are CMT (cut make trim) manufacturers, which receive cloth from their buyers and return the final product. The largest ones (ran by Italian expatriates) are OEM (original equipment manufacturers) which produce under the specifications of the buyers (without receiving the inputs). Those who started later, after the year 2000 are mostly platforms (structures that co-ordinate pools of CMT subcontractors, all working for the same firm in Italy), services (i.e. the embroidery workshop) or foreign direct investment – Italian-owned factories that produce only for the parent company (usually an OBM manufacturer, or a mixed company working partly as OBM and partly as OEM) located in Italy. The exception is the Romanian subcontractor (CMT) that started in 2005. In this case, a personal relation of trust played a leading role in a spin off: the owner of an Italian platform encouraged the director of a Romanian factory to start an independent entrepreneurial activity.

Table 4.3: Evidence of the shift from Italy to Timisoara of the apparel value chain

Year of establishment of the firm	Origin of the capital	sub sector	Clients
1989	Romania	Subcontractor (CMT)	Italian OBM
1997	Italy	Subcontractor (OEM)	99% Large multi-national
2000	Italy	Dye works	Apparel producers. The most important is a large multi national
2001	Italy	Mixed (OEM)	Subcontractor for Large multi national + producer for parent firm in Italy
2003	Italy	Platform	Parent firm in Italy
2004	Italy	Platform	Parent firm in Italy
2004	Italy	Producer (CMT)	Parent firm in Italy
2005	Romania	Subcontractor (CMT)	Italian OBM
2005	Italy	embroidery	Apparel producers

This geographical shift into Timis of a consistent section of the apparel value chain allows understanding better the impact of growing wages and a less favorable exchange rate on Italian clothing producers in Romania: some of them, namely, the independent subcontractors, will be under much higher pressure than other components of the value chain:

> A few businesses, responded well to the new situation. Particularly the ones, which control the entire value chain, from production to the sales, even if this last part do not take place in Romania. This is because they can spread out much better margins, costs and earnings. Instead, businesses working only as sub-contractors suffered the most (interview president, Timis branch, Unimpresa Romania: 04-03-06).

Also, given the Chinese competition in the low-end products, all subcontractors have been under pressure to raise quality in order to work in the high end market.

Third, the open system described as far the relationship between firms and banks in the third chapter is at work also among the various components of the apparel value chain. I.e., an Italian producer will not necessarily work with an Italian supplier. Again, this situation penalizes subcontractors. While some services (as the die works and the embroidery workshop interviewed in this fieldwork) enjoy a quasi-monopoly rent, because they brought technologies previously unavailable in Romania,[21] Italian and local subcontractors are in direct competition:

> I work with just a few Italians. I prefer Romanian subcontractors, because I can trust them more in the long term. Italians may leave. Also, there is no real quality difference between Italian and Romanian subcontractors (Interview Italian entrepreneur, platform: 04-14-2006)

Fourth, and perhaps more important from the point of view of the role of Italians in the transformation of Timisoara, this shift of the apparel value chain in Western Romania has been made possible by the creation of a large Italian expatriate community, consisting mostly in people with entrepreneurial skills. The following personal history highlights how the economic trends described so far reflect in a growing personal involvement of individuals in the city:

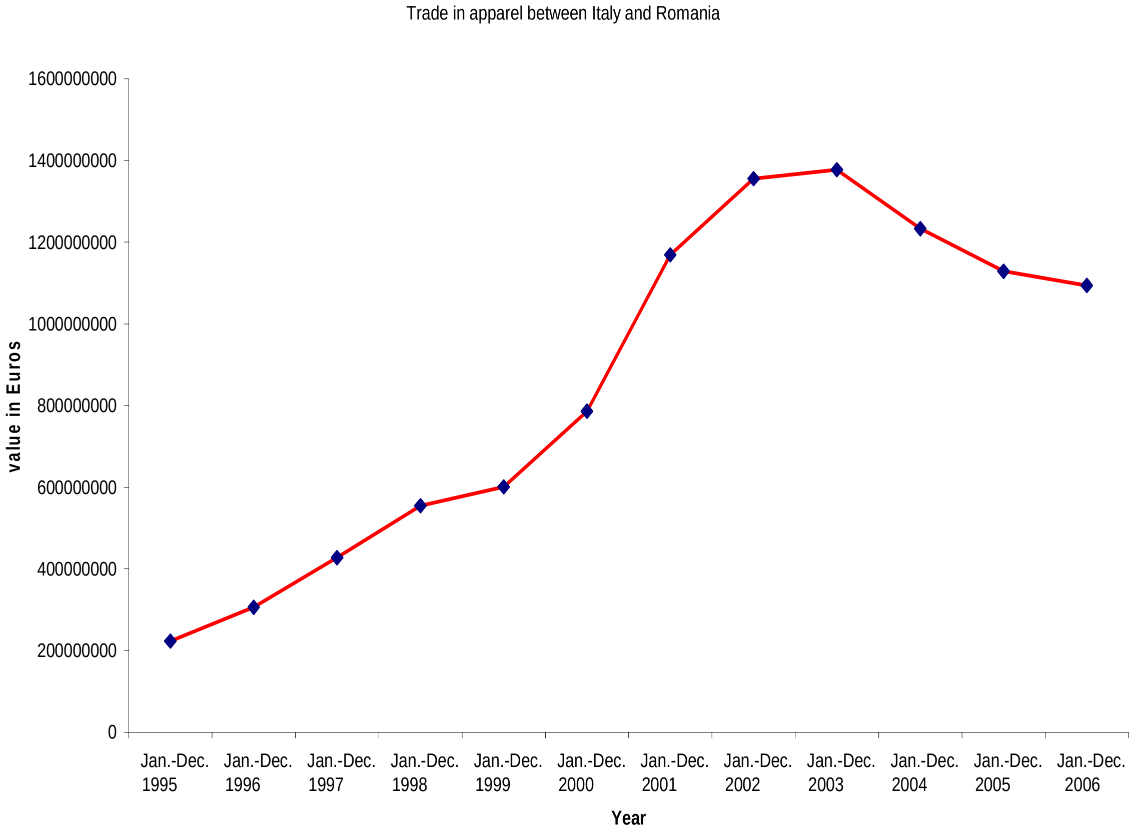
> In Italy I had a firm with two partners. At the end of 1989 a political refugee from Timisoara came to work in our firm. In 1990 we came with him to Timisoara, and decided to set up a workshop here. In the first years things went well, and we created a platform to manage a pool of subcontractors. In 1998 we decided to start a large factory, and appointed a Romanian to start it up. After two years the job wasn't done yet, so I had to move here. In one year, we had our own factory with one hundred and eighty employees, plus we managed 52 subcontractors.[22] Then I had an argument with my partners: they wanted me to do everything, thinking that things in Romania work like in Italy. It is not the case, and it was just too much

[21] For example, they brought in Romania a new laser cutter which allows the design of thicker leather embroideries.
[22] This is a quite common arrangement in the apparel sector: in order to absorb seasonal fluctuation, the core of the production is done internally, and the extra is done by subcontractors.

> work for me alone. After I left, there was nobody managing the factory. Six months later it closed.
> Then, I became director for a large multi national, which had a production unit here. Three years later they closed to unit here and moved to China, so I lost the job. Then, last year I started this firm (interview Italian entrepreneur in Timisoara: 04-21-06)

This excerpt shows the initial role of a local person in attracting the Italian firm in Timisoara, the initial phase based on low capital involvement, centered on a subcontracting relation; the growth and the establishment of a platform and the following start up of a direct investment. It also shows the growth of the personal involvement of the entrepreneur that accompanies the increase of the financial commitment, which culminated in moving permanently to Timisoara. Finally, it shows how the stable presence of a community having both financial means and entrepreneurial skills may contribute to the start up of new firms beyond the initial investment. The condition of expatriates is shared by most of the entrepreneurs interviewed: with the exception of two, who shuttle between their firm in Italy and the one in Romania, they are all permanent residents of Timisoara.

Graph 4.1 Trade in apparel between Italy and Romania
Source: Author elaboration of COMEXT data



4.3.5 Italian participation in the post-socialist transformation of the institutions of Timisoara

At this level of an emerging community of expatriates that the Italian economic presence in Timisoara translates in a direct participation in the life of the city, and the broader processes of development upon which the ‘Timisoara miracle’ is based:

> Some manufacturers still operate in the Timisoara area. These entrepreneurs have a mentality different from the early waves of subcontractors, who came here to speculate, I consider them more ‘evolved,’ because they think about Romania as their own homeland. They know that, living the 70% of their life every year in Romania, this is their home. Thus they come to build enterprises in Romania, and do not come as predators, but organize their business as at home (Interview Italian accountant, Boscolo & Partners Timisoara: 04-05-06).

Institutionally, this participation takes the form of membership in the local chamber of commerce: even though they less then 10%, Italian firms are by far the largest foreign group represented in the chamber of commerce (see Table 4.4). At the same time, Unimpresa is developing its role of interface between Italian firms and local institutions. In Timisoara, this translates in a close relationship between Unimpresa and the chamber of commerce:

> In Timisoara, Italian businesses have very good relationships with the local chamber of commerce, to the point that in May there will be the election of the directive council of the chamber, and I was asked to run for the vice-presidency. This is because, since the Italian presence in this area is very strong, they want to have an Italian representative in the chamber. Consider that my wife and I live completely in Romania from 1998 (interview president, Timis branch, Unimpresa Romania: 04-03-06).

It translates also in an engagement with the government, both at national and local level:

> at local level we are interlocutors of institutions, for example, in the discussions about territorial planning, creation of industrial parks etc. we do it at national level, as Unimpresa Romania, and local level, as local branches (interview president, Timis branch, Unimpresa Romania: 04-03-06).

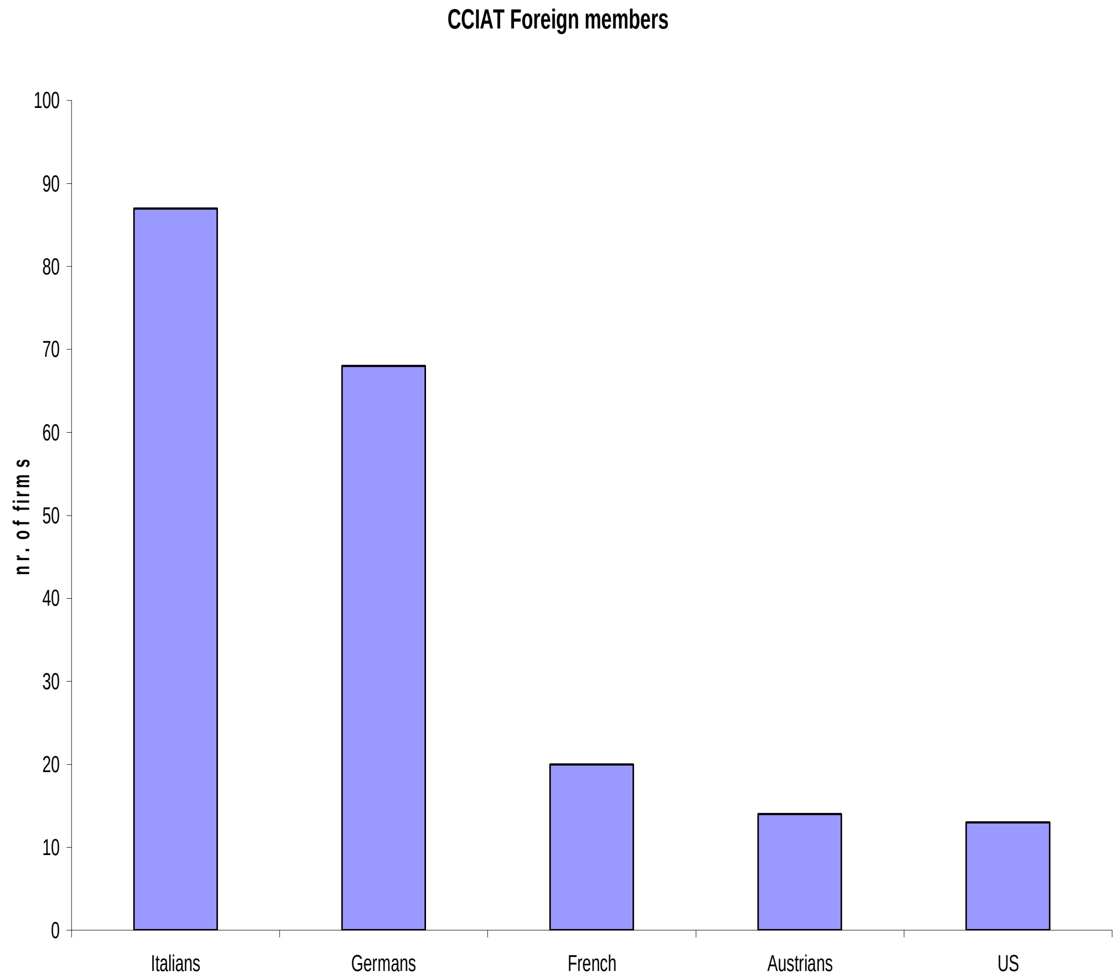
Finally, the establishment of a large community of Italian firms attracted the attention of both the national and local governments of Italy, which provide a few financial and institutional instruments to support the internationalization of the Italian economy. This took the form of international institutional chains described above: for example, ADETIM receives a small financial support from the Italian government and it has many EU funded projects in partnership with Italian institutions, and one of its project managers is specialized in working with Italian partners. Also, representative offices of Italian institutions have been established in Timisoara: the Institute for Foreign Trade established a correspondence point within the Italian consulate in November 2004; the Regional governments of Veneto and

Lombardy have representative offices since 2002, and the Italian government financed the establishment of information centers in Timisoara and other six cities in Romania. They are all located within the Department of External, Internal Economic Relations and European Integration of the Chamber of Commerce. These offices have overlapping duties: for all of them, an important part of the work consists in 'trade promotion,' i.e. disseminate information about opportunities and legislation and support the encounter of Italian and local firms through fairs, events and missions, i.e. they support entrepreneurial activity as far the establishment of joint ventures. Therefore, they introduce a formal, institutional component to the spontaneous process of networking that led to the successful establishment of Italian firms within the 'Timisoara miracle.'

Table 4.4: Most represented foreign members in the Chamber of Commerce, Industry and Agriculture of Timisoara

Source: CCIAT, 2006

Members of CCIAT	Italians	Germans	French	Austrians	US
1,020	87	68	20	14	13



4.4 Conclusions

In conclusion, the ‘Timisoara miracle’ – a higher than the national average economic growth in the context of an highly diverse manufacturing and trade sector, which mixes foreign firms and local entrepreneurship – is underpinned by a coherent economic policy from the local government (the Strategic Development Concept) having a precise, neo-liberal, ideological orientation. The following peculiarities in Timisoara liberalism emerged: the investor-friendly institutional environment is coupled with local people – at all levels, from city administrators to trade unionists to entrepreneurs - ability to discriminate among them, which is usually done in a moral discourse of ‘serious’ and ‘non serious’ investors. Second, a set of historical and geographical factors, the ‘Timisoara exceptionalism’ provided the city with good assets to attract investors (geographical position, levels of education, pre-existing industries) and popular support for the high social costs required by the restructuring of the local industries, which reflects in a pattern of local elections favoring right wing parties. Third, local institutions themselves have changed in transition, and this could happen because of a far sighted local leadership. Particularly, the old bureaucracy has been left substantially in place, but it has been sided with new agencies (ADETIM, ADRVEST, Chamber of Commerce) which received funds and structure from the European Union, and whose jobs consists both in supporting private investors (Chamber of commerce) but also implementing grant projects in co-operation with institutions from EU countries. The implementation of these agencies has a direct impact on the political transition of Timisoara, because the new agencies are modeled upon Western European models, and the projects themselves involve know-how transfers into the local agencies. There is also an important indirect impact: through projects, information about the region and its potential begins to circulate, often in informal networks, among potential interested parties.

Unlike German firms, which came to Timisoara as direct consequence of the local government policy of attraction of large, hi-tech industries, Italian firms began to move to the city and county in the early 1990s without an explicit institutional support. The early comers were mostly light, traditional industries in the apparel and shoemaking sector, which followed their own professional networks and personal relations of trust. The evolution of the Italian economic activity in Timisoara followed broader, national and supra-national level trends. Particularly, there has been a succession from low tech, low capital involvement in the form of subcontracting towards more capital intensive, higher tech involvement in the form of foreign direct investments, which are increasingly oriented towards the local market. This evolution has followed closely national level macro-economic trends, such as GDP growth, growth of average salaries and fluctuations in the exchange rate of the local currency over the euro. This process did not involve only a shift from traditional sectors to higher tech ones. Analyzing the Italian apparel industries in Timisoara, this research shows that a similar process occurs within the clothing sector as well. Particularly, the early waves of subcontractors have been followed by other elements of the value chain (large producers establishing their own factories, commercial firms importing sewing machines and providing technical assistance, suppliers of accessories, more advanced services as die-works), some of them coming with large and high tech investments. Therefore, the macroeconomic trends in Timisoara are putting considerable pressure on some elements of the value chain, especially on the independent subcontractors, while others are still growing.

The growing involvement of Italian firms in the city determined the establishment of a large expatriate community. Through members of this community the Italian economic presence translates into the participation in the processes of post-socialist transformation of the local institutions described above. Particularly, Italians take part in the city’s life through the local branch of Unimpresa and their participation in the chamber of commerce. Also, the large presence of Italian firms pushed Italian institutions towards a more active co-operation with local partners and the establishment of representative offices in the city.

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Chapter 5
Industrial districts… with or without Italians? Miroglio investment and cluster policies in Bulgaria

5.1 Overview

In the previous chapters, the internationalization of Italian firms in Eastern Europe has been described as an historical progression in which low capital involvement in the form of subcontracting in the early 1990s was followed by heavier investments. In turn, the shifts in the composition of Italian investments were heavily influenced by national-level macroeconomic trends, while at local level networks of interpersonal relationships played an important role in the locational choices of firms. This chapter analyzes the ways in which these factors played themselves out in Bulgaria. Then, these general trends will be applied to the Italian textile industry, which, in Bulgaria, is dominated by the large investment of the Miroglio group. In so doing, the chapter investigates some of the ways in which the 'Italian model' of 'industrial districts' is being exported to Bulgaria.

The existing literature shows that one of the features of the Bulgarian post socialist transformation is the emergence of clusters of small firms resembling Marshallian industrial districts. The comparison between industrial districts in Italy and Bulgaria is not new (Begg, Roukova, Pickles and Smith: 2005). The literature points out that, in the clothing industry, networks of small firms have emerged, mainly working as subcontractor for foreign producers (Begg, Pickles, Roukova: 1999). More recently, increased competition on the global market has led the Bulgarian textile industry to adopt new strategies, which include the stabilization of supply networks, industrial upgrading and development of the local market (Pickles, Smith, Roukova, Begg, Bucek: 2006), which further increases the similarities between the Bulgarian and Italian industries. This chapter pushes the analysis beyond the textile and clothing industries, showing that two further layers must be considered in order to fully appreciate the impact of the 'Italian model' on the re-organization of the Bulgarian economy. The first is the influence of large Italian groups such as Miroglio. The second is the set of policies that the Bulgarian government is currently adopting in order to encourage a further development of Marshallian industrial districts. To analyze the interplay between these two issues, this chapter asks the following research questions: How does Miroglio investment fit in the overall pattern of the Italian involvement in Bulgaria? What is the interplay between Miroglio and the local industry? What kind of issues are the government's cluster policies raising?

5.2 The internationalization of Italian firms in Bulgaria

Although Romania and Bulgaria are neighboring countries, with similar GDP per capita[23] and a similar path of accession to the EU (they both entered the Union on January 1st 2007), the pattern of Italian investments in the two countries is substantially different. While in Romania, Italian firms were active in large numbers since the early 1990s, in Bulgaria the Italian investments took off in the second half of that decade (interview general secretary, Italian Chamber of Commerce in Bulgaria: 10-31-05). The first recognized pull factor for Italian entrepreneur in Bulgaria was a set of neo-liberal reforms. Unlike Romania, Bulgaria suffered from the wave of financial crises of 1997 and, as Thailand, Indonesia, South Korea

[23] In 2005, Bulgaria was 66th and Romania 67th in the world GDP per capita ranking compiled by the IMF. Bulgaria GDP per capita was USD 9,223, Romania USD 8,785. (Source: IMF: electronic document).

it went through IMF led structural adjustment policies (Berlemann and Nenovsky: 2004; Dobrinsky: 2000). From the point of view of Italian firms, this meant an increase in opportunities due to an increased pace of privatization and a more stable currency, pegged to the German Mark, and then to the Euro:

> The recent history of the economic relations between Italy and Bulgaria presents two milestones. The first is the year 1997, with the conclusion of the financial crisis in Bulgaria, which led to hyperinflation and bankruptcy of many commercial banks. Bulgaria overcame the crisis through an agreement with the IMF… This agreement allowed Bulgaria to dramatically reduce inflation, pegging the currency first to the German Mark and then to the Euro. The agreement required important sacrifices, mostly in terms of transferring authority from the central government to the local authorities, maintaining the wage level in the public administration, at the cost of reducing employment in the state sector. This allowed the reorganization of the financial sector first, and then of the whole economy, that was made possible by a new and intelligent privatization policy and a new attitude towards foreign direct investments. In this new climate, Italian investments in manufacturing began to flow: textile, apparel, shoemaking sectors, and then all the investments linked with privatization: Miroglio, Italcementi and others. (Interview Chief Economic Official, Italian Embassy in Bulgaria: 11-04-2005).

As part of the IMF led privatization policies, the Unicredit Group could acquire the largest Bulgarian bank, which in turn increased the confidence of Italian investors in the Bulgarian market:

> The second [milestone] is the year 2000, with the acquisition by the banking group Unicredito of Bulbank, the most important Bulgarian bank. …. The privatization of the banking sector in Bulgaria happened under IMF control, and it was done in a good way, involving reliable players. … The acquisition of Bulbank allowed the multiplication of our economic presence in Bulgaria, because the presence of a large Italian bank is an important support for the investments of Italian manufacturers. The proof of this is that 75% of the Italian businesses in Bulgaria are Unicredit clients. Moreover, in the banking sector there is a very healthy competition, because in Bulgaria operate important groups with a strong corporate tradition in assisting and supporting entrepreneurship. These banks are introducing in this market new instruments and new possibilities: leasing, quicker circulation of money, larger offer of loans; in short, new engines for development. (Interview Chief Economic Official, Italian Embassy in Bulgaria: 11-04-2005).

In the early 2000s the Bulgarian government targeted Italy with promotional initiatives aimed at attracting Italian investments:

> The peak has been in the last four to five years, with the appointment of the former Prime Minister Simeon Saxe-Coburg Gotha (2001-2005). Son of Tsar Boris the III and Queen Giovanna, he is half Italian. He favored Italian investments in Bulgaria. He actively promoted Bulgaria in Italy with several business missions, and he made a very well receiving field for companies. (Interview president, Italian Chamber of Commerce in Bulgaria: 10-31-05).

These national level trends had a direct impact on the sector and size of Italian firms investing in Bulgaria. First of all, being a latecomer in receiving Italian investments, Bulgaria did not experience the progression from low tech and low capital to high tech and high capital as Romania did. When Bulgaria began to attract Italian firms, that process was already underway throughout Eastern Europe, and both small and large firms were seeking investment opportunities in the region. Therefore, from the beginning Bulgaria received a mixed portfolio of small and large Italian firms:

> We are not like Austrians, which have very concentrated investments, or Greeks, whose investments are really fragmented. Italy has a mixed composition of its investments, comprising both large investments (ENEL, Italcementi, Miroglio, and our own Unicredit group), and a range of medium sized companies, which are the real strength of our system. These are companies with a turnover (in Italy) of fifteen up to seventy millions of Euros, which brought here part of their activity, never all of it. (Interview high level manager, Bulbank: 05-22-06).

In the textile and clothing industries, the outcome of this process is that the geographical concentration of a great number of small to large Italian producers, based on a community of Italian expatriates described in the previous chapter in the case study of Timisoara, did not happen in Bulgaria. Instead, in Bulgaria a single large Italian group – Miroglio – has a dominant position. An analysis of the case study of Miroglio, and its impact on the local inter-firm relations through the establishment of forward and backward linkages follows.

5.3 The Miroglio investment in Bulgaria

5.3.1 The choice of investing in Bulgaria

Miroglio is a medium-large group in the European textile and clothing industries: with a turnover of Euro 950 billion, it holds the 100th position among Italian companies, and it is in the top five Italian textile producers (Interview country manager, Miroglio Bulgaria: 05-17-06). Notwithstanding its large size, it describes itself as a 'family business,' i.e, top management and ownership coincide, and are kept within the Miroglio family. As for internationalization, Miroglio anticipated the Italian trends by almost a decade. Confirming a pattern already stated in the literature (Baldoni, Sdogati, Tajoli: 2000) the apparel division moved first, followed by the textile division two decades later:

> The Miroglio Group has two large divisions, apparels and textile. The apparel division began to outsource very early, back in the 1970s, when we closed some garment manufacturing plants in Italy to open progressively in North Africa, beginning with Morocco, Tunisia, later Egypt, etc. Even in that case we anticipated future trends, because the massive part of Italian de-localization took place in the 1980s and 1990s. In the late 1990s the textile division was still strongly rooted in the homeland, as it was the case of most large European textile producers, and obviously we decided to look at Eastern Europe, that at that time had just passed transition and was going towards stabilization. (Interview country manager, Miroglio Bulgaria: 05-17-06).

Looking more closely at the mechanisms leading Miroglio to Bulgaria, a pre-existing connection with the country since Socialist times influenced the choice:

> Miroglio had a very strong trade relationship with Bulgaria since the mid 1980s up to the time when the direct investment started. We already knew the country; we had relationships with several companies which worked for us as subcontractors. We already had a micro-structure. Miroglio registered its first company in Bulgaria in the mid 1980s; it was a platform that managed the import of raw materials, outsourced the production to Bulgarian subcontractors and re-imported in Italy the semi-finished product to perform the final stages of production. This business was very well developed: with only a manager for customs duties, one accountant and two managers supervising the subcontractors and a technical control from Italy, (with technicians coming and going) it had a turnover of 5 million meters of cloth per

> year at its best. We brought fibers or thread and we produced the cloth here with OPT trade. In fifteen years of activity of this company, we got to know normative, geographical, even personal aspects of Bulgaria. We established a good number of personal relationships and contacts that turned to be important when we decided to invest. (Interview country manager Miroglio Bulgaria: 05-17-06).

Second, the choice was finalized in part because of the above-mentioned macroeconomic policies and the IMF reforms:

> The group had similar structures in Romania, and I think in other countries in this area too, but in the end we chose Bulgaria. First of all, we were attracted by the tradition in the textile, and then by the good relationships we had here. Another reason is linked with the fact that the decision to invest was taken in late 1997. It had been an extremely important year for Bulgaria; in my opinion it was the year in which the new Bulgaria was founded. From 1989 when Communism fell to 1995 nothing changed in Bulgaria: same oligarchies were in power… Well, they still are, but now it is not official… privatizations didn't start yet, all things you probably know. From 1995 to 1996 the country reached the bottom-line, banks went bankrupt, the entire system collapsed, there was hyperinflation. In 1997 IMF came, the currency board was established, and the Leva was pegged to the German Mark and then to the Euro. The political climate totally changed, and the political and institutional premises for investments were created. I have to say that in our investments we never related directly to the political establishment. We didn't receive financial or other kind of support, we weren't corrupted, and we didn't corrupt. However, the creation of a stable political climate, and thus a stable macroeconomic environment, together with legality and certainty of the rules for sure attracts investments.
>
> In summary, after choosing Eastern Europe we opted for Bulgaria because we already knew this country, and because of the new political situation. This was just beginning, and it was a far-sighted choice to bet on Bulgaria, because in 1997 we couldn't know that the new system would eventually consolidate so quickly and deeply, as it did. (Interview country manager Miroglio Bulgaria: 05-17-06).

This description allows illustrates clearly the qualitative difference between the internationalization of a large group and the internationalization of small to medium enterprises analyzed in the previous chapter. SMEs go international often relying on a personal-basis trust relation, and maybe the support of a consultant when available. Obviously, a large group as Miroglio could count of an already established network of relations, and enough human resources, to consider options worldwide. Also, the size of the group allows tapping into the resources that local governments provide to attract foreign investments, which is not often the case for small businesses. In the specific case of Bulgaria:

> In August 2004 a new law for the development of investments was promulgated. …It identifies three classes of investments:
> I Investments greater than 70 million levas (around 35 million Euros). These investments receive state aid in the form of infrastructural interventions (roads, water supplies, energy supplies etc.) geared towards the needs of the investor, up to the border of the plot of land where the investment is located. …
> II Investments between 40 and 70 million levas (20 to 35 million Euros) receive individual services from the agency, but do not have right to the infrastructural interventions
> III Investments between 10 and 40 million levas. They receive informational support about procedures, but not individual services or state aid (Interview state expert, Investbulgaria agency, Ministry of the Economy and Energy of Bulgaria: 10-27-05).

Obviously, Miroglio qualifies as a Class 1 investment.

> We have a fifth plant in the city of Iambol, which is in the making now. Last week we were appointed with a certificate of first class investment from the ministry of economy. This law was not there yet when we made our earlier investments (it was approved last year in July), but we are benefiting now because the investment is still in the making. (Interview country manager, Miroglio Bulgaria: 05-17-06).

However, being a family business, and Miroglio had to face some of the same issues as small firms do. Particularly, for both large and small Italian firms internationalizing in the 1990s the overseas location had to be close enough to allow 'the family' to control the business (Interview country manager, Miroglio Bulgaria: 05-17-06). Second, the segment of the textile industry in which Miroglio operates is highly time-sensitive, so logistics have to allow quick transportation to market (ibid.). Small apparel producers working in the high end may face the same issue, which a) allows the industry to survive in high cost areas, as shown in the London case discussed by Smith and Evans: 2007 and b) shape its patterns of productive de-localization towards areas close to the final markets (Nordas: 2004). Also, Miroglio works in a sector which requires high professional skills (Interview country manager, Miroglio Bulgaria: 05-17-06) therefore areas with pre-existing traditions were preferred. Finally, 'cultural proximity' – defined by Miroglio managers in the broad terms of ‘feeling at home’ and ‘feeling comfortable’ played a leading role, because of the difficulty of finding managers that accept to work in remote or unpleasant areas (ibid.). The combination of these factors pulled small and large Italian firms alike towards Eastern Europe.

5.3.2 Structure of the Miroglio investment

Overall, by early 2006 Miroglio investment in Bulgaria in the textile sector[24] comprised five factories with an investment of around 200 million euros and one thousand five hundred employees. The structure of the investment is summarized in Table 5.1. It consists in two large plants specialized in the final product of the textile sector (i.e., cloth), plus three other plants specialized in intermediate phases. The geography and the typology of Miroglio investments provide a key in interpreting the group’s strategy in Bulgaria. Miroglio started its activity in Bulgaria in 1998-1999 with a greenfield investment in the town of Elin Pelin, twenty minutes drive from Sofia. A combination of cost-saving strategy and proximity to the input market is evident in this plant. Elin Pelin is specialized in the traditional Miroglio product – printed and dyed cloth – which is sold to the group’s main customers, which are large retailers such as Zara, H&M and Benetton, plus the group’s apparel division, ‘Vestebene.’ Besides producing the cloth, the plant has a design and product development department. Therefore, the locational choice has been a combination of technical needs, of having access to both low cost labor for the production and high skills employees to manage the plant and for the product development:

[24] The group has other collateral investments besides its core business, as, for example the ‘Interpred’ business center located in the outskirts of Sofia

> [In Elin Pelin] we built the factory from scratch, following these criteria:
> 1) Technical criteria: we needed a high amount of water, because printing the cloth requires a lot of water. Then we needed infrastructure: electricity pipes and methane gas pipes.
> 2) Logistics: we needed a place outside a city, but close enough to bring in personnel with management, technical and design skills. For that plant design is very important, because we develop our products here, and we wanted to bring in young women, designers that we could find in Sofia but not in the deep province. Thus we chose this site thirty five kilometers from Sofia, which has a labor market dynamic similar to the province, together with the possibility of letting high skills employees commute from Sofia. (Interview country manager, Miroglio Bulgaria: 05-17-06)

The second investment is located in Sliven, three hundred kilometers away from Sofia. It involved the acquisition and restructuring of an already existing facility, a vertically integrated plant producing woolen cloth. The logic behind this operation was the acquisition of technical skills new to the group, in order to enter a new market.

> [In Sliven] we acquired an historical company, with around one hundred years of history. Of course we invested a lot, because it had a lot of history but not too much substance, in the sense of outdated technology and very old and poorly kept machinery… in that case people skills were very important. While we were and are market and technology leaders in the printing of cloths, at that time we weren't in the wool sector at all. We didn't have technical know how, so we bought that plant to acquire new professional skills. Notwithstanding the really outdated technology, in Sliven the know-how was very good. We could join this with our very strong sales network, which is one of the densest in the world in the textile sector. It came out a very successful marriage between their technical skills and our commercial capacity. (Interview country manager, Miroglio Bulgaria: 05-17-06).

The following three plants are all located in the area close to Sliven, and specialize in intermediate products, which partly serve the two main plants, partly sell to customers external to the group. In these cases, the logic behind the locational choices was centered on the availability of industrial spaces, left empty by the collapse of the Socialist industry and available for privatization at a low cost:

> [Our first two plants] produce a finite product that goes to the final clients, who are the big retailers: Zara, H&M, and Benetton. For this reason, the criteria for choosing the geographical location were more important. [The three more recent facilities] produce a semi finished product, for which geographical location and logistic is less important. Thus, we chose areas close to Sliven, which became the center of our industrial activity, and we bought already

> existing industrial buildings. Of course, we invested in the machinery and improved the buildings, but we started with an already existing "box," as we call it. We could buy at good prices industrial buildings adapted to our objectives. This makes the work much easier, because we can skip all the preliminary part: feasibility study, research, getting permits from the State, construction. You buy, and the next day you can start your work. Thus, in all these three cases the criteria of choice was to find industrial buildings at interesting prices in interesting areas, which allowed us a quicker start up. (Interview country manager, Miroglio Bulgaria: 05-17-06).

In sum, the geography and the typology of Miroglio investments in Bulgaria highlights a richer strategy than the simple cost saving through cheaper labor at the shop floor and lower utilities cost. These are important components (as shown in the Elin Pelin case) but not less important than tapping into the local high skills design market, the acquisition of know how in wool production and the opportunities offered by the privatization of Socialist industrial facilities.

MAP 5.1: Geography of the Miroglio investment in Bulgaria

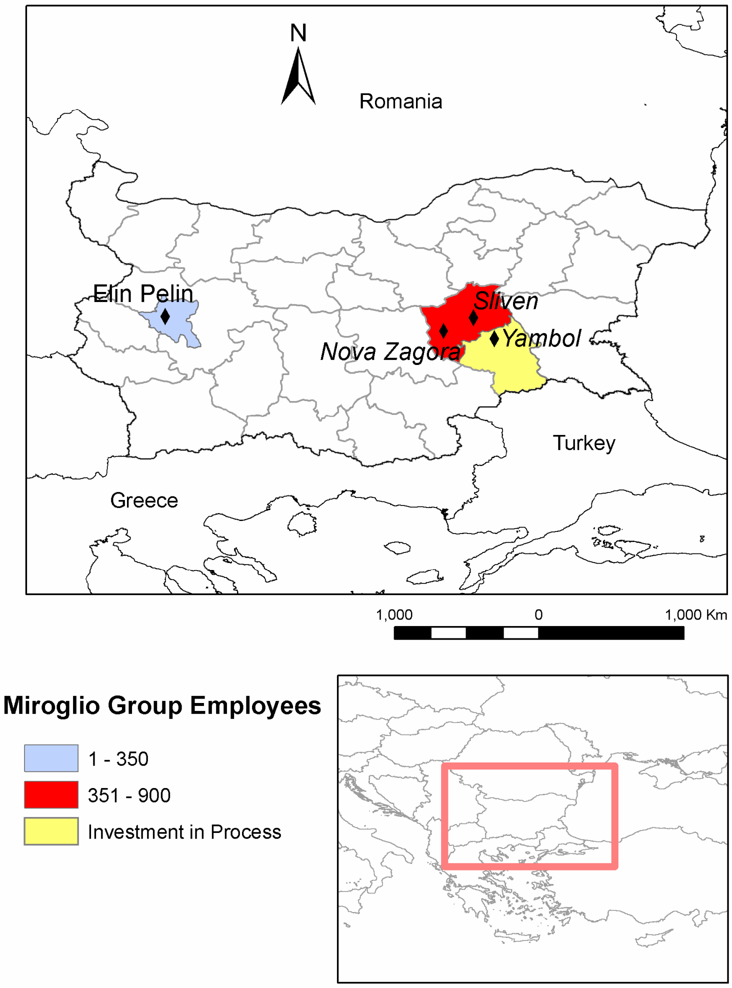


Table 5.1: Structure of the Miroglio investments in the textile sector in Bulgaria, 1998-2006

Source: Miroglio Group, 2006

Location (in chronological order of the investment)	Typology	Production	Capital invested (millions of Euros)	Nr. of employees	Motivation
Elin Pelin (20 km away from Sofia)	Greenfield	Printed cloth	45	350	Large amount of water, Close enough to Sofia to access to high skill labor (designers), but lower general costs than Sofia itself
Sliven 1 (300 km from Sofia)	Acquisition	Woollen cloth	75	600	Acquire know how in the wool sector
Sliven 2	Brownfield	Polyester and rayon viscose	25	150	Produces raw cloth to be processed in Elin Pelin
Nova Zagora (near Sliven)	Brownfield	Intermediate process in polyester and rayon viscose production	40	150	80% of production is for Sliven 2
Iambol	Brownfield	Woollen yarn	40	Not completed at interview	

5.3.3 Miroglio as a promoter of backward and forward linkages with locally based firms

Besides tapping into local resources, the Miroglio group has been active in establishing backward and forward linkages with locally-based firms. In terms of backward linkages, there was a conscious attempt to export the Italian model of industrial districts and inter-firm co-operation. Over time, the shift from domestic owned to foreign owned firms had a negative impact on this project:

> [initially we established] co-operation with other companies: we did something of what in Italy works very well, such as distributing the work among other companies in the peak periods; this is the famous concept of [industrial] districts. This works less and less, because the Bulgarian textile industry is shrinking more and more due to lack of investments. (Interview country manager, Miroglio Bulgaria: 05-17-06).

Instead, inter-firm co-operation has been established on a more reduced scale, with two other foreign investors in Bulgaria, the Italian Safil and the French Devawrin:

> [Bulsafil] is another Italian company, we have a quite intense co-operation with them, we provide them some things, and they provide us other things. There are three important investments in the textile sector in Bulgaria. Ours is the largest, then there is Bulsafil (Safil is the name of the mother company in Italy), then there is Devawrin, which is a quite important French group, they have an investment here for the preliminary treatment of wool. We do co-operate with them, at level of swapping production, and also as both clients and input providers. (Interview country manager, Miroglio Bulgaria: 05-17-06).

Looking at the strategies of Miroglio, Bulsafil and Devawrin combined it emerges that, as far backward linkages, the most evident feature of the textile industry is the co-relocation of input suppliers. This is very clear looking at Devawrin, specialized in the import of wool from the Southern Hemisphere and in the early stages in wool processing:

> In 2001 the management decided to shift Devawrin industrial production from France… they visited several countries in Eastern Europe. They chose Eastern Europe because of our customers: an important part of our market is in Turkey; besides this, [by 2001] many of our Italian customers had already moved to Eastern Europe. Therefore, Bulgaria was a good option as for low costs, and at the same time it is strategic as far trade. Third, it is a stable country. Foreigners feel safe here. Bureaucracy is difficult, but in the end bureaucracy is difficult everywhere… Italian customers are the largest part of our market. This is because Italians are very strong textile producers. (Interview high level manager, Devawrin: 06-18-06).

This phenomenon of re-location of the value chain does not affect only strategy; customer-supplier relations can provide information and support for the re-location process.

Again, the good relationship between Devawrin and its customer Bulsafil provided the channel to organize the early visits to the future site of the investment:

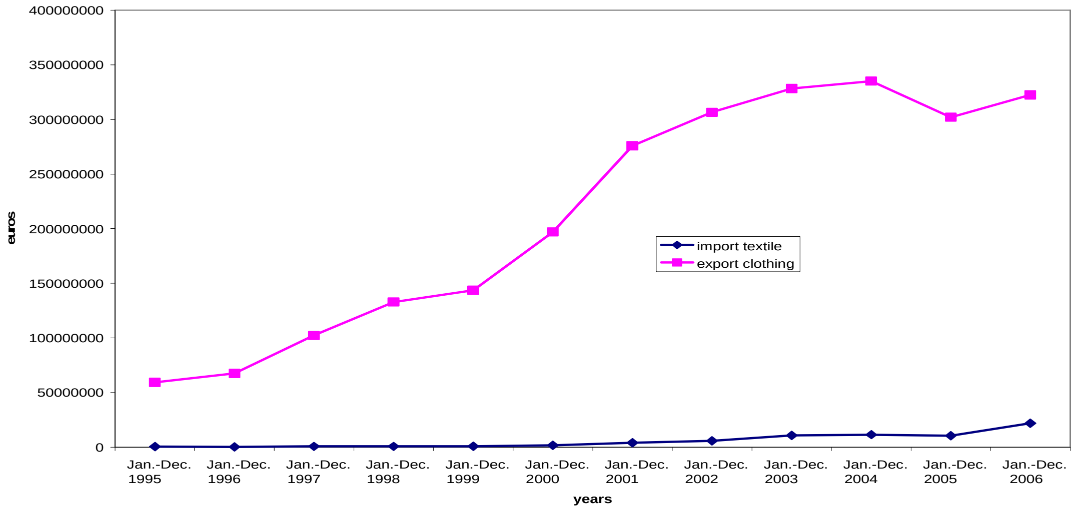
> Q. How did you choose this location, Parvomai near Plovdiv?
> A. Devawrin has excellent relations with Bulsafil [located in Plovdiv]. They have been in contact on this issue, and Devawrin came to visit the area. They compared it with the other areas they visited, and they chose it. I think one element of choice was to be not too far from Bulsafil and Miroglio: it would have been illogical to go somewhere else, given that here we are close to two very large customers. Here we are halfway between Miroglio and Bulsafil. Then, they chose Parvomai for technical reasons: it was already connected with natural gas and electricity pipelines and it is rich of water. (Interview high level manager, Devawrin: 06-18-06).

The co-relocation of input suppliers affected also medium-sized firms:

> In the chemical sector, paint suppliers followed Miroglio. There are three or four Italian firms in the chemical and yarn sector, and other suppliers that followed Miroglio and Safil, and re-located in Bulgaria, choosing areas close to Miroglio and Safil (Interview Italian Consul in Plovdiv: 06-06-06)

As far as forward linkages, a vibrant network of local apparel producers has been developing in Bulgaria since the early years of transition (Begg, Pickles, Roukova: 1999). Many of these firms rely heavily on subcontracting relations and outward processing trade with Western European own brand manufacturers. As it is well known in the literature (see, for example, Smith: 2003 for a discussion of the Slovak case; Begg et al. 2003 for a broader discussion of regional trends and Jones, Parvulov: 1995 for an analysis of the changes in the Bulgarian industry in the years following the collapse of state socialism) much or the revitalization of the clothing industry in Eastern Europe after the collapse of the planned economy is due to sub-contracting relations between local producers and Western European firms. Graph 5.1 illustrates the phenomenon for Bulgaria: comparing the import of textile (delivered from manufacturers to their subcontractors) and the export of clothing (i.e., the finished product) between Bulgaria and the EU core, it allows to appreciate the dynamism of the Bulgarian industry.

Graph 5.1 Import of clothing and export of textile from the EU core to Bulgaria
Source: author elaboration of COMEXT data



Miroglio has stepped into this process: instead of sending the cloth to its customers in Western Europe, and letting them arrange the shipments to their Eastern European subcontractors, it provides delivery directly to the subcontractors. This kind of intermediation reduces the timing and the costs of transport in the textile-apparel value chain.[25] It also affects the amount paid in taxes, as the following discussion of the value added tax shows:

> Then we have another form of co-operation with the apparel producers. Usually our Italian clients buy from us the cloth, and then they outsource the production to Bulgarian subcontractors. We sell to these Bulgarians, but this is just an intermediary step, because the final product is Italian…. If we weren't in Bulgaria, in this kind of relationship the subcontractor would not receive our bill, which would go directly to the Italian manufacturer. Here, because of the law on VAT, we have to send the bills to the subcontractors. Instead in Romania we send the bills to the Italian (or French, or English) manufacturer, but we deliver the goods directly to the subcontractor. Instead, since we are in Bulgaria, if we would send the

[25] Exact data non available.

> bill to the foreign customer and deliver in Bulgaria we should include a VAT that the customer could not recover, because he or she is not a Bulgarian entity. In summary, our real customer is a foreign company, which asks us to deliver the goods here to its Bulgarian subcontractor. (Interview country manager, Miroglio Bulgaria: 05-17-06).

Overall, this mechanism is influenced by, and contributes to, the relocation in Eastern Europe of the whole textile-apparel value chain:

> This entails a very important co-operation, which is one of the reasons why we came to Bulgaria. The first reason is of course the low cost of labor, but the second is that the center of the apparel production has shifted dramatically towards Eastern Europe, thus it is an important service to provide a locally produced cloth to manufacturers that produce here. (Interview country manager, Miroglio Bulgaria: 05-17-06).

In absence of exact data, the impact of such strategy on the value chain can be inferred from other sources. Particularly, Matthias Knappe (*conference paper: 2004*) has shown that in the cost structure of a woven shirt at FOB point,[26] fabric is by far the most expensive item, accounting for 59% of the all costs. By comparison, the cost of assembly labor accounts for 7%, and the profit of the manufacturer for 10%. In this condition, any reduction in the price of fabric may impact the overall cost more than a reduction in the labor costs: for example, a 10% reduction in labor cost will reduce the overall cost of less than 1%, while a similar decrease in the cost of fabric will reduce it by 6%. Therefore, by cutting fabric transport costs, the above mentioned strategy has a very large potential impact on the cost structure of the whole value chain. Also, shorter delivery time for the fabric is particularly important for the high end sector of the apparel industry that has to respond quickly to changes in fashion. Time sensibility contributes to the competitiveness of Eastern European based producers, for whom the shift towards high end, time sensitive products and

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[26] FOB: Stands for "free on board." Describes a price which includes goods plus the services of loading those goods onto some vehicle or vessel at the factory door (http://economics.about.com/cs/economicsglossary/g/fob.htm).

the proximity with Western Europe is becoming a widely adopted strategy to increase competitiveness (Pickles, Smith, Roukova, Begg, Bucek: 2006, Pickles: 2006).[27]

However, in establishing forward linkages with apparel producers, Miroglio has to face the highly fluid trends of that industry. Especially the increasing costs in the Bulgarian apparel industry are putting some pressure on the strategy outlined above:

> However, as OPT producer, Bulgaria will loose appeal, because wages are growing, and the country is shifting from low wage to medium wage. In Europe there are still low wage countries, like Moldova, Macedonia, Albania, while Bulgaria is less and less interesting for who does pure OPT trade, CM and CMT manufacturing… Our relationship with the local apparel producers has been positive for the time in which we presented local subcontractors to our customers. Bulgarians are well prepared from a technical point of view, thus there has been a good satisfaction among manufacturers working with them as subcontractors. However, prices were interesting, but they are becoming less and less so. (Interview country manager, Miroglio Bulgaria: 05-17-06).

In order to respond to this issue, which is perceived as a challenge to the group's own interests in Bulgaria, Miroglio is taking some proactive action in order to encourage the upgrading of the local apparel industry. At odds with the conventional vision that the best way of upgrading is through the development of own brand manufacturing, Miroglio is supporting local producers in accessing the market of global suppliers. This requires a qualitative change in the local industry:

> Bulgaria could become a product proponent, an intermediate step between OBM and CMT. The biggest difference between the CMT and the final product is the development of the collection. Who does CMT is somebody who stays in his company, and receives the visit of a technician, who says: this is the model, this is the cloth, how does the assembly cost? Then there are more structured manufacturers, who come to us, buy some cloth, develop their collection, take a flight to, for example, La Coruna, where Zara has its headquarter, and say: "I show you my collection of shirts. Do you want make me an order?" In between there is an entire world of companies that don't do a complete collection, but start to go out and propose a mini collection, to which the clients often requires some updates and changes. This kind of service could keep Bulgaria competitive. (Interview country manager, Miroglio Bulgaria: 05-17-06).

[27] See also: Abernathy et al.: 1999; Abernathy et al.: 2006, Bair: 2006.

Concretely, Miroglio has set a large exhibition area, the 'Fashion Floor' (http://www.fashionfloor-bg.com/en/index.php) in Interpred, a large business center the group owns in the outskirts of Sofia, aimed at establishing contacts between global buyers and local producers:

> Here, in this business center, property of our group, one of the few investments we have outside the textile sector, we set up a structure called "International Fashion Floor." Here offices are rented to the most various kinds of companies: we have the World Bank, embassies, IBM, and others, but we reserved one floor for enterprises in our sector. Our aim is to facilitate the contacts between these companies and the large international clients, to give them the necessary visibility to enter certain networks. Consider that many of these producers are located hundreds kilometers away from Sofia, and a potential buyer would probably say "If I go to Istanbul knowing that I can find in three hours one hundred and fifty apparel producers, why should I come to Bulgaria and travel several days in the province just to meet them?" Thus we created this Fashion Floor to give the Bulgarian producers a chance to get closer to the world of the big buyers, a world that requires not only sewing, but also some commercial and design skills. (Interview country manager, Miroglio Bulgaria: 05-17-06).

However, the success of this initiative, at the time of the interview (Summer 2006) was considered limited, due to the limited financial capacity of many of the local firms:

> Unfortunately, so far Bulgarian companies aren't responding well. The shift from the pure OPT trade to a higher step requires entrepreneurial mentality, which is scarce, requires some financial capacity, because you must buy some cloth, design and assemble samples, pay airway tickets to someone who will go to meet the buyers… These days in Bulgaria it is too interesting to invest in the real estate and other sectors, so those with money prefer not to invest in manufacturing. (Interview country manager, Miroglio Bulgaria: 05-17-06).

In sum, Miroglio has been very active in establishing backward and forward linkages with locally based firms, attempting to re-produce the system of inter-firm relations of the Italian industrial districts. The crisis of the Bulgarian textile industry has limited the activity of Miroglio in the backward linkages, which had to concentrate on partnerships with two foreign owned large firms. However, the foreign direct investments of Miroglio and Bulsafil attracted the re-location in Bulgaria of some of their suppliers. In the realm of forward linkages, Miroglio is acting as mediator between its Western European customers and Bulgarian subcontractors, while at the same time undertaking some steps to encourage the upgrading of the local industry.

5.4 The role of the 'Italian model' in the re-organization of economic policy in Bulgaria

5.4.1 The introduction of the concept of 'industrial districts' among Bulgarian policy makers as an outcome of international co-operation

At the same time that Miroglio was structuring its forward and backward linkages, consciously attempting to reproduce its own domestic model, the Bulgarian government has attempted to follow the Italian model of industrial districts in designing economic policies. The goal of this section is first of all to describe how and why these policies are being implemented and, second, to discuss the peculiarities that distinguish Bulgarian cluster policies from the models from which they are inspired.

In Bulgaria, the formulation and implementation of policies supporting networks of small firms is directly connected with the transnational institutional networks described in the previous chapters. The concepts for these policies – called 'cluster policies' in Bulgaria, following Porter's lexicon – were first introduced by local think tanks and international agencies. The Foundation for Enterprise Development, Bulgarian think-tank active since the 1990s (see www.fed-bg.org) was one of the early proponents of clusters:

> Until two or three years ago, there was no talk about clusters in Bulgaria. Only we and an American agency did projects about clusters…. [Besides doing consultancy work and research] we act as a think tank, introducing new ideas in Bulgaria. The idea of the Bulgarian Innovation Fund is ours, as the introduction in Bulgaria of clusters as a policy tool. For the Ministry of Labor, we carried on a project on the development of alternative employment (Interview chairman of the executive board, FED: 10-26-05).

One of the earliest examples of a policy oriented study involving Bulgaria, which used the concept of cluster is the Virtual Cluster Identification (VICLI) project (http://www.informest.it/vicli/index.htm) implemented between 1999 and 2001. The project itself is an example of the ways in which the transnational institutional chains are mobilized. VICLI had been financed by grants provided by European Union (INTERREG II C Community Initiative – Operational Programme CADSES) and national institutions, namely the Italian Ministry of Infrastructure & Transport and the Hungarian Ministry of Agriculture and Regional Development. The project was carried on by a consortium of regional and local authorities together with their development agencies in Italy, Hungary, Romania and Bulgaria, coordinated by Informest as the mandated body of the Italian regional government of the Autonomous Region Friuli Venezia Giulia.[28] In turn, these institutions appointed the actual design and implementation of the project to specialized professionals who are public equivalent bodies or non-profit foundations. The Italian public agency Informest (www.informest.it) drafted the project design, arranged the fund raising and coordinated the implementation. The centrality of professional consultants in such project can be better understood looking at the history and structure of FED, which had been the implementing agency for the Bulgarian part of VICLI:

> We started fifteen years ago as a team leading the biggest Bulgarian association of SMEs, from 1991 to 1997. In 1997, we became part of a joint Bulgarian-Dutch project aimed at

[28] See http://www.informest.it/vicli/english/b/b2.htm for a complete list of the institutional partners

> establishing a support structure for businesses. As a consequence of this project, we became a think tank supporting the emerging private sector. We were constituted as non-profit organization, and we took the name 'Foundation for Enterprise Development.' Thus, as staff we have been working together for fifteen years, we are the only team which has been operative for such a long time.
> As a SMEs association we were supported financially by our members. When we constituted ourselves as foundation, we were supported for the 40% by the Bulgarian-Dutch project. When the project was concluded the Dutch funds ceased, and we started to work as NGO training consultants. Nowadays the financing of the foundation comes for the 80-90% from our activity of consultants for EU projects. In the EU projects, usually the funds go to ministries, which distribute them to consultants, who organize teams for the implementation. In this framework, we contributed to establish many structures, and trained their personnel.
> Besides the consultant work with the EU funds, we also do research (recently, in a project funded by the World Bank), and we work a lot for NGOs. We had a project from CIPE, a large American NGO, affiliated with the US Chamber of Commerce; from the Soros Foundation we received a project to train municipalities to prepare for the application of EU funds. …
> Our team is constituted by a permanent staff of ten, five researchers – one lawyer, one sociologist and three economists – and five support staff. Besides this, we co-operate with ten scientists (usually they are associate professors) to carry on projects on SMEs development, regional development, NGO development. In these broad areas, we do research, training, consultancy, dissemination of information, participation to projects. (Interview chairman of the executive board, FED: 10-26-05).

Like the Romanian agency ADETIM analyzed in the previous chapter, FED owes its present structure to a project funded by a Western European donor. Through its activity of training state officials, FED built over the years a reliable set of interpersonal relationships with government officials at all levels. Through its activity with international NGOs and donors, it has established a strong international network. As a result, the foundation has a built-in capability to implement internationally designed projects at the local level, strongly supported by its deep involvement in entrepreneurial environment of its Country.

The VICLI project consisted of interview-based research involving firms and local government officials in selected areas in Hungary, Romania, Bulgaria and Italy, focus groups, policy evaluations and workshops (for more details see *Activities and Results:* http://www.informest.it/vicli/english/b/b4.htm). The aim of the project has been the diffusion of the Italian model of industrial districts, especially from the standpoint of identifying policies that local governments can implement in order to strengthen local small and medium enterprises by improving their “external economies”:

> The Italian case study is internationally known as a model of good practice for SMEs development and clustering. *The main condition of this success is the appropriate strategic territorial planning* of a friendly environment for firms. At the same time, the permanent improvement of measures aimed at entrepreneurial support in territorial management is always requested also in Italy, in particular at regional level (VICLI: http://www.informest.it/vicli/english/b/b1.htm; italics added).

At the same time, given the strong participation of Italian institutions in the project, the promotion of further co-operation between Italian and Central European institutions and firms had been one of the relevant components of the project:

> The results are then represented by:
> · An original catalogue of problems and opportunities of district economies in their territory, at the disposal of local communities,
> · *The presentation of good practices and cooperation opportunities among companies and among institutions of Italian districts and of districts emerging in the other participating Countries;*
> · the diffusion of culture referred to industrial districts and needed measures for the support to its development among competent Public Administrations, both in Italy and in other Countries where districts are still potential. (VICLI: http://www.informest.it/vicli/english/b/b1.htm; italics added).

5.4.2 The introduction of ‘cluster policies’ as part of the economic reforms in Bulgaria

The activity of the Foundation for Enterprise Development, and transnational institutional chains such as the VICLI project are examples of the ways in which policy concepts based on the notion of Marshallian industrial districts were introduced in Bulgaria. Three years after VICLI, these policies gained momentum, thanks to the personal interest of the then Minister of the Economy:

> In the Fall of 2003 the then minister of the economy, Lidya Shulieva told in an interview to a newspaper about clusters and their success. I don't know where she got the idea from; for sure she is a well educated economist, so she had options to get to know it from many sources. Following that article, in Spring 2004, the Council for Economic Growth, an inter-minsiterial council involving several ministries and associations decided to be active on the cluster issue. Since then, we are step by step institutionalizing clusters. (Interview high level official, Ministry of the Economy: 05-23-06).

The interest of the national government in cluster policies translated in a stronger involvement of large international donors, specifically the PHARE program from the European Union (now completed) and the United States Aid Agency, USAID. Within the Ministry of the Economy, the Small and Medium Enterprises and Entrepreneurship Department manages the so called 'cluster initiatives.' The head of the Department summarized the introduction and early stages of implementation of cluster policies in Bulgaria as follows:

> We started to work on the idea of clusters two years ago, in 2003, and since them I work on this issue within the Ministry of Economy. Everything is just beginning. The Ministry, together with NGOs and branch organizations did some research and analysis of industrial sectors where there is potential for the development of clusters, following two criteria: potential of development, and amount of SMEs, i.e. those for whom the cluster will give more opportunities of development. This is done according to the theory, which states that the organization in clusters gives SMEs opportunities that usually are limited to larger firms. We found some promising sectors: first of all, clothing and textiles, food processing, tourism, wood processing and furniture, chemical, machine building, electronics and ICT.
>
> Starting last year we had around ten work meetings and seminars which put the seeds of the idea of clusters among businesses. The meetings were organized by the Ministry of the Economy and addressed branch organizations, like the Organization of Textile producers in Rousse. The topic was always the idea of clusters, what are the advantages and requirements in the EU context, and presented the idea as one of the means to increase competitiveness of our firms in EU context. By the end of the last year we did at the ministry an overview of the cluster initiative.
>
> This year we started two pilot projects financed by PHARE on the development of clusters. The first, with the title of 'implementation of the cluster approach' concerns the development of the national strategy and action plan for the development of clusters and the mapping of the potential clusters. This project started already: we identified a team of consultants, collected some material; it will go on until November of the next year. Since it is in its initial phase, we do not have preliminary findings yet. We want to produce a map of Bulgaria with clusters potential and constituted. At this point, 'constituted' clusters means that firms met and signed a memorandum of understanding to co-operate in the cluster initiative; 'potential' cluster means that they are still thinking about it. However, no concrete action had been undertaken yet, because we are at the initial step and to implement any action we need money, which our state cannot afford to spend. However, in the beginning of 2007 will start the next PHARE

project, which will fund ten to fifteen cluster structures, for a total of 3 million of Euros. Overall, the first PHARE project is developing the criteria to evaluate clusters and cluster projects, while the second one will concern the actual implementation of projects. (Interview high level official, Ministry of the Economy: 11-14-05).

The above-mentioned projects[29] are similar in structure to the smaller scale, VICLI. In all cases international donors provide money, which in turn activate international co-operation, whose outcome is geared towards the 'import' into Bulgaria of new policies, geared towards financing changes in institutions aimed at facilitating the development of Marshallian industrial districts. The first outcome of these projects has been the diffusion of knowledge on clusters in meetings and conferences,[30] sometimes using specific examples from the Italian industrial districts. Following these meetings, the Bulgarian government has formally established a certain number of 'clusters' throughout Bulgaria, as summarized in Table 5.2.

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[29] More details on the USAID sponsored project can be found at the web pages of VEGA (the USAID sponsored initiative), http://www.vegaalliance.org/. The EU sponsored project was part of the now expired PHARE program. Brief description of PHARE: http://ec.europa.eu/enlargement/financial_assistance/phare/index_en.htm (access: 2007-02-24). the reference for this specific project is: PHARE Programme BG2003/004-937.02.03.

[30] An example is the *National Seminar on Cluster Development* held in Plovdiv on June 14 2006, in which several speakers draw examples from Italian industrial districts. Calendar of the event available at: http://preview.creato.biz/nbox/calendar/files/451_Plovdiv_national_event.pdf (access: 2007-02-24)

Table 5.2 Establishment of clusters in Bulgaria in the period June 2004 – April 2006

Source: Ministry of Economy and Energy of Bulgaria

Denomination/sector	Region	Year of establishment
Textile cluster 'Bulgarian Silk'	Rousse	2004
ICT Cluster	Sofia	2004
Cluster 'Tourism Rhodopi – BG'	Smolyan	2004
Industrial cluster 'Varna Port West'	Denya	2004
Industrial cluster 'Srednogorie Med'	Pirdop	2005
Cluster 'Furniture made in Troian'	Troyan	2005
Industrial cluster 'Energy Heart of Bulgaria'	Stara Zagora	2005
Tourism cluster 'Northern Black Sea Region'	Varna	2005
Cluster 'Laser & Optics'	Plovdiv	2005
Textile cluster 'Apparel & Textile'	Haskovo	2005
Food processing cluster 'Traditional Bulgarian Products on European Table'	Stara Zagora	2006
Cluster 'Production of Agricultural Equipment'	Rousse	2006
Eco-industrial cluster	Pernik	2006
Cluster 'Bulgarian Media & Printing'	Plovdiv	2006

5.4.3 The transformation of the concept of 'industrial districts' following its introduction in Bulgaria

After the introduction of the concept of 'cluster' or 'industrial district'[31] as a tool for policy making, Bulgarian actors involved in these policies reworked it according to their needs and experiences. Particularly, clusters are assimilated to the market economy version of the production unions (*stopanski obedineniia*). In socialist times, the production unions were industry based organizations responsible for the implementation of the five years plans. They assured the smooth functioning of the inter-firm relations and the timely deliveries of inputs among state-owned enterprises. Basically, in absence of the interplay between demand

[31] local actors use the two terms as synonyms; or, more precisely, they use the Porterian definition 'cluster' and understand it as the kind of interfirm co-operation of which Italian districts are considered to be examples. The academic distinction between the Porter interpretation, in which clusters performances depends from competition, and Becattini interpretation, in which industrial districts are based on a mix of co-operation and competition, is lost in the Bulgarian discourse.

and offer that characterize market economies, the production unions were administrative bodies that organized the commodity chain of each industry. Because cluster policies stress the importance of inter-firm co-operation among firms belonging to the same sector and links with the local administration, clusters are considered similar to the production unions. A local official described the role of *stopanski obedineniia* in the Socialist economic system as follows:

> In the past we had *stopanski obedineniia*, that now are called clusters. They were closed cycles of production. We had small firms which produced details, that went to a larger firm for the assembly of the components, and finally to a big plant for the assembly of the final product. All the economy was organized in these *stopanski obedineniia*, which were unified in a ministry… The planning committee at CMEA met at the beginning of the five years plan to decide the list of production and its distribution among members. Then the committee had annual meetings where prices – expressed in the CMEA value - and quantities were negotiated. Then, orders were sent to ministries in each country, and from there to the stopanski obedineniia, where the production was organized, allowing enough time to negotiate the furniture of raw materials and components. Finally, each producer was linked with an organization for foreign commerce (koraboimpex etc.), that sold to its equivalents in other CMEA countries. (Interview chairman, Chamber of Commerce of Rousse: 11-18-2005)

The parallels and differences between these structures and the industrial districts are drawn as follows:

> Contemporary clusters work exactly like the *stopanski obedineniia*, except for one difference: in the latter there was one director, while in the former there is no vertical co-ordination… Now, like before, intermediate prices are set at cluster level, but now there is no a director that co-ordinates the cluster. (Interview chairman, Chamber of Commerce of Rousse: 11-18-2005)

> Under State Socialism we had these structures. We had unions of firms belonging to the same sector. In the textile sector there were several of them, like the union of silk producers in Rousse. These unions were responsible for the organization of supplies and for the realization of production. The state decided what and how much produce, but the actual co-ordination was made by the *stopanski obedineniia*. Thus, there is an analogy between clusters and these structures. The most important difference is that clusters are based on SMEs and their reciprocal relations. Instead, in socialist times everything was centralized, producers didn't have to think, everything was already organized for them. (Interview high level official, Ministry of the Economy1: 11-14-05).

> Q. What is in your view the difference between clusters and *stopanski obedineniia*?

A. When we go to meetings with local branch associations and administrations many people ask this question. I always answer that the *obedineniia* were well functioning mechanisms in a planned economy, while now we are looking forward to implement well functioning mechanisms in a market economy. Since the context is different, everything is going to be different. (Interview high level official, Ministry of the Economy2: 05-23-06).

Besides this re-interpretation of Socialist structures, cluster policies are actively used as a mean to attract funds from the European Union and other donors to promote the re-structuring of the economy. At local level, a probably unique example of the ways in which cluster policies have been adapted to the local needs and at the same time used to attract external funds is represented by the City of Rousse. In Rousse, where a dense network of interconnected clothing producers has emerged (see VICLI project for more information on the Rousse region, esp. http://www.informest.it/vicli/english/c/c-bu-rou.htm) a local leader established a Business Support Center (the BSC web page is www.bsc.rousse.bg) which used the concept of 'cluster' as both a model to structure firms' support and attract funds as follows:

The Business Support Center began to work in 1994. ... In 1996 the BSC won the first PHARE project, thanks to the co-operation with a British consultant who understood very well what we wanted to achieve here, and we started to do real things. We started the first business incubator in Bulgaria, and went to the US for two conferences. After this we were able to convince two Austrian consultants to support a further request of funding, and we got one additional million of dollars. With this money, we organized the second business incubator and the first scheme for leasing of machinery. Later we obtained $50 thousand from the US government for a fund for support of SMEs, which we used to create a guaranteed fund to finance agricultural businesses…

Nowadays, there is a program funded by the EU to develop clusters in the whole country. However, projects financed with these EU funds have to be co-financed at 50%, and require the presence of foreign consultants. These foreigners do not know the reality of the Bulgarian market and for firms to pay around a quarter million of euros for useless advice is not convenient. We are working and hoping to get EU money at more convenient conditions… To develop our cluster, we started with very little information, and then we made several visits to Italy to see how clusters work there. Then, after the visit of …, an American consultant expert in logistics, we understood that we were close to our goal. Particularly, we do not want to take the idea of clusters wholesale, we want to adapt it to our reality. In concrete terms, here technology centers are very important, because our companies cannot afford the cost of introducing the new equipment. To develop a center for management, logistics and design is similarly important, for the same reason. (Interview executive director, BSC-Rousse).

However, the assimilation of the new cluster policies to the local conditions does not always result in positive outcomes as in the Rousse case. Especially the perceived similarity between 'industrial districts' and '*stopanski obedineniia*' has been identified as an obstacle to the diffusion of cluster policies by both local and foreign policy makers:

> The memory of the old structures is one of the reasons why it is difficult for businesses to co-ordinate, because many still remember the old system. Now clusters are emerging under different principles. For example, the cluster in Rousse is emerging because firms often do not have the capacity to meet the demand of foreign buyers, so they pass each others orders. (Interview high level official, Ministry of the Economy1: 11-14-05)
>
> Here there is a Freudian reaction against the role of Communism and its policies of collectivization and nationalization. As all totalitarian regimes, when it fell there had been first a great sense of freedom, followed by an exacerbated individualism. This creates a concrete obstacle to the realization of industrial districts as we know them (Interview Representative of Emilia Romagna in Bulgaria: 05-26-06).

In sum, through the introduction of cluster policies, the Bulgarian government, with the support of international donors, is actively attempting to develop forms of support geared towards increased competitiveness of small firms. These policy concepts have been introduced and developed largely through forms of international co-operation at an institutional level, mobilized through projects funded by international donors as USAID and the European Union. However, in the early phases of implementation, it is evident that the same concept of 'Marshallian district' is being re-worked and adapted to the local context. In the case of Rousse, local leaders used this concept to maximize the impact of external funds on the local economy, channelling foreign funds towards the implementation of business incubators, new logistics and technology needed by local producers. The role of the Business Support Center in organizing foreign resources allowed minimizing the intervention of foreign consultants, significantly reducing the cost of policy implementation. In other cases, the perceived similarities between the Marshallian districts and the old mechanisms of management of the Socialist economy generated some resistance against policy plans, especially because policy makers have been highlighted the importance of inter-firm co-operation in a post-socialist climate of exacerbated individualism.

5.5 Italian investments in Bulgaria and local policies: missing or emerging link?

There is no evident connection between Miroglio activity in establishing backward and forward linkages, thus bringing to Bulgaria its own experience and culture of Italian industrial districts and the Bulgarian government 'cluster policies.' Looking more closely at this remarkable *absence*, two issues emerge. The first concerns the obvious problem of transferring a foreign system in the local context. The second concerns the specificity of the Italian presence in Bulgaria.

Even though Bulgarian officials are acutely aware of the need to adapt the idea of 'clusters' to the local level, one issue is generally overlooked. As the whole literature on industrial districts has long made clear, an important component of the Italian experience has been the role of local governments in promoting the local economy. Instead, in Bulgaria decentralization is just beginning and local governments are only slowly gaining new competencies. This institutional disparity alone prevented the bilateral initiatives based on the concept of 'transferring' the Italian experience:

> I think that the road in Bulgaria to implement that process that allowed Emilia Romagna to realize the most advanced experience of industrial districts is still long. This is because the Emilia Romagna districts are rooted in a very strong relationship between the territory, the urban planning and the production capabilities of any given area. That is a system connecting production, innovation, logistics and transport networks, international connections, activity of the chambers of commerce … Instead, here the system still needs to develop. … I have to say that Bulgarian democracy is not fully developed yet, especially from the standpoint of decentralization. Power hasn't shifted them from the ministries to the local governments. This has a potential impact on economic development…

> [In Bulgaria] there is an excellent local entrepreneurial class. The problem is not the entrepreneurial class, it is 1) in the political class, because politicians and administrators are those who set in motions the economy, the towns and 2) in the class that manages the entrepreneurial associations and all the services and processes that help Bulgarian enterprises to grow in the international market. Here people think that growth equals export increases. This is reductive and short sighted: together with export promotion, you need to create paths connecting politics, urban planning and development projects that can integrate firms and their territory. Then you can support this with introduction of know how, innovation and competition in the international markets. Without all of this you can't have industrial districts. (Interview Representative of Emilia Romagna in Bulgaria: 05-26-06).

In turn, from the standpoint of Italian firms, Miroglio activity in deepening backward and forward linkages does not constitute *per se* an attempt to influence local policies in order to build a business environment resembling Italy. The previous chapter on Romania showed that the participation in the local policies has been mediated by the rooting in the local environment of a community of expatriate entrepreneurs, which has constituted entrepreneurial associations as the mean to interact more coherently with the local governments. In Bulgaria, a few large firms, among which Miroglio, have been active promoters of such association:

> In the year 2000 the Committee of Entrepreneurs was constituted; it is the first association that aggregates Italian firms in Bulgaria. It starts following a directive of the Italian Government, which invited firms to constitute associations to start a dialogue with local institutions. It was called 'Consulting Committee' because it was meant to represent the interests of entrepreneurs in the dialogue with institutions. The Italian ambassador was the president. It had no operational duties; it had only to speak for entrepreneurs in the dialogue with institutions. It was registered as a private association; it had thirty or forty members. In 2006 the members are 175, located in the whole Bulgaria. This growth shows that there was a need among entrepreneurs for association. In 2004 the duties of the Committee increased, and it constituted as a Non profit organization. (Interview Consulting Committee: 05-22-06)

However, the re-combination of Italian firms in Bulgaria into a coherent system is a perceived need, which has to face some problems to be further implemented:

> I think that the way the Committee works shows how Italian entrepreneurship works. In Bulgaria there are many Italian SMEs that were attracted by the large firms, like Miroglio,

> ENEL, Bulbank and others. These large firms are the core of the Italian system in Bulgaria. Without them there would not be any system. They give a positive imagine to the Italian entrepreneurship here. Behind them there are great many small and medium Italian firms that invested here (these are Bulgarian firms with Italian capital), which let alone would not be able to develop a coherent system. The Committee enhances the system, but also shows the difficulty of establishing such a system. Only in the past two years it has started to expand its activity and implement deeper changes. The hardest challenge to the committee comes from within. Many of its associates have very little attitude to work together. We are very far from expatriate industrial districts. Everybody is on his or her own. (Interview Consulting Committee: 05-22-06).

Therefore, the participation of Italian investors in a development strategy modelled upon the Italian industrial districts is still an open question. The answer depends first, from the outcomes of cluster polices, i.e., the kind of 'industrial districts' that will emerge in Bulgaria. Second, it will depend from their ability in generating a coherent interaction with the local institutions.

5.6 Conclusions

This chapter has shown that the Miroglio investment is part and parcel of a broader trend of Italian economic presence in Bulgaria. First of all, the group built its own internationalization strategy upon already established relations of trust. However, unlike the small and medium enterprises analyzed in the previous chapter, a large group like Miroglio has such relationships in several countries. The final choice of Bulgaria depended on a series of crucial economic reforms. Particularly, the IMF-led structural adjustment policies adopted by the Bulgarian government following the 1997 financial crisis increased Miroglio's confidence, and allowed the group to finalize the decision to invest in Bulgaria. Once established in Bulgaria, the group adopted a complex strategy, which combined cost-saving initiatives, adoption of the local know how and re-utilization of existing structures. In so doing, it proceeded to establish backward and forward linkages which resemble the Italian tradition of industrial districts. However, while the backward linkages have been limited to the co-operation with two others large foreign owned firms, because of the decline of the local textile industry, forward linkages established a scheme of inter-mediation between Bulgarian firms and foreign producers, which included an initiative to encourage the upgrading of the local industry.

Miroglio is not the only example of promotion of the Italian model of industrial districts. The Bulgarian government, supported by international donors and thanks to the activity of international institutional chains, has developed policies and is currently developing grant schemes to further enhance systems of inter-firm co-operation directly inspired to the Italian experience. However, no link has been established between the two initiatives. Looking at the reasons for this absence, it emerged that the concept of industrial districts in Bulgaria is being re-worked, especially because the still heavily centralized administration and the socialist experience of the *stopanski obedineniia* bring about conditions very different from Italy's.

Chapter 5 - Bibliography

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Chapter 6
To Be or Not to Be [in the EU]: That is the Question. Investment Strategies of Italian Firms and Local Policies in the Border Region between Slovakia and Ukraine

6.1 Overview

> One of the most profound consequences of these processes [of trade liberalization and increased international competition] is the further relocation of garment production away from the core sites in Central Europe which have sustained the industry over the last 20 years, to lower cost locations in the former Soviet Union, South Eastern Europe and beyond (Smith et al.: forthcoming)

What is driving this second wave of internationalization of the Western European garment industry, from the by now familiar and consolidated locations in Central Eastern and South Eastern Europe towards new spaces outside the boundaries of the European Union? The existing geographical literature points to the combined effects of the changes in the international trade regime, and especially the expiration of the Multi Fiber Agreement on January 1st 2005 (Pickles: 2006, but also EU High Level Working Group: 2004, Nordas: 2004, OECD, 2003; Oxfam, 2004; Palpacuer et al, 2005; UNCTAD, 2005; US-ITC, 2004) new forms of supply chains management (Abernathy, Volpe, Weil: 2006), super-national (EU) and national policies (Palpacuer: 2006, Smith et al.: 2003, Begg et al 2003, Tewari: 2006) as the main factors re-shaping the spatial organization of the textile and clothing industries in the early years 2000. Smith et al. (*forthcoming*) analyze the ways in which these factors influence the spatial re-distribution of the garment industry throughout Eastern

Europe. Particularly, they investigate "the emergence of partial, yet increasing, cross border production relocation to Ukraine as one specific strategy to attempt to deal with interregional cost differences and increasing competitive pressures." (Smith et al.: *forthcoming*, p. 3). Part of their argument examines the relationship between cross-border trade, EU policies and regulations towards the Former Soviet Union, and the historical ties between Slovakia and Trans-Carpathian Ukraine. The emergence of Western Ukraine as a player in the new round of European outsourcing has been noticed by Kalantaridis (2000), who first highlighted the inclusion of the Uzhgorod region in the global textile value chains via the mediation of firms located in Slovakia and Hungary (p. 287) (see also Kalantaridis et al: 2003; Labrianidis and Kalantaridis: 2004). From the standpoint of Italian firms, Micheal Dunford (2006) argues that the Italian textile and clothing firms are organized around an 'interdependent geographic system' organized around the material and immaterial service firms located in Milan (Dunford: 2006, p. 29), which has been spatially characterized by subsequent waves of re-location over time (ibid. pp. 52-55).

This chapter builds on these arguments, describing the newest wave of re-location of Italian firms, showing the ways in which actors within the EU (in Slovakia) and outside (in Western Ukraine) are shaping the phenomenon. Particularly, it considers the ways in which Italian investments are embedded in the local institutional environments within and outside of the EU highlighting the impact of an EU versus non EU environment on firms' strategies and behavior. The chapter asks the following research questions. What does it mean from the perspective of Italian firms to be inside or outside the space of the European Union? How does it reflect on the transnational institutional chains discussed in the previous chapter? How does it reflect on the institutional arrangements at the local level? In order to answer these questions, this chapter will discuss 1) the case studies of Italian firms establishing facilities in both Slovakia and Ukraine and 2) compare two local communities, Kralovsky Chlmec in Slovakia and Tyachiv in Ukraine, in order to understand the two paths of post socialist transformation at local level.

6.2 The ‘domino effect’ between Eastern Slovakia and Western Ukraine

In the previous chapters the process of internationalization of Italian firms in Eastern Europe has been described as a progressive growth over time and progressive diffusion in space, starting from subcontracting relations in the light industry, to arrive to foreign direct investments in a wide range of sectors, which has been accompanied by growing commitment of banks and service firms. With respect to this model, Slovakia and Ukraine are located at the two ends of the spectrum, Slovakia being an area of established Italian investments, and Ukraine being an area of growing attraction. This section first discusses the institutional differences between Slovakia and Ukraine from the standpoint of Italian firms, and then discusses firms’ case studies, to highlight the difference between a ‘mature’ area of investment and a ‘new’ one.

6.2.1 Different conditions affecting Italian firms in Slovakia and Ukraine

A comparison between Slovakia and Western Ukraine highlights the two ends of the process. In Slovakia Italian investments have been developing since the early phases of the transition. As shown in Chapter 3, it has been one of the pioneering areas for the internationalization of Italian banks and service firms. Besides this, it has an active Italian Chamber of Commerce. From the standpoint of institutions, it has been the first country achieving EU membership (on May 1st, 2004) among those considered in this study. From a macroeconomic prospective, Slovakia in 2005 had a GDP per capita of USD 16,041, almost double that of Bulgaria (USD 9,223) or Romania (USD 8,785) (source: IMF, electronic document). Because of this reason, the competitive advantage of Slovakia is not on low wages anymore (interview Italian service firm). Instead, in Ukraine the penetration of Italian banks and service firms is just beginning: Unicredit entered Ukraine only with the merger with the Austrian HVB in 2005 (source: Unicredit, webpage). Especially in Western Ukraine, the establishment of Italian service firms is moving its early steps as well. The IC&Partners Group is currently (Spring 2007) just exploring the possibility of establishing itself in Ukraine (Interview entrepreneur, EDAS: 09-26-05). There is no officially recognized Italian Chamber of Commerce in Ukraine (*source*: Association of Italian Chambers of Commerce Abroad, webpage). Also, Ukraine is not a candidate country to the accession to the EU;[32] it has a GDP per capita significantly lower than Bulgaria and Romania – with USD 7,213, in 2005 Ukraine ranked 86th as far GDP per capita, while Romania was 67th (IMF, webpage). In sum, the structures that in the previous chapters have been identified as sources of an emerging system of governance for Italian firms abroad are well established in Slovakia, while they are absent or in the early stages in Ukraine. Also, the 'transnational institutional chains' discussed in the previous chapters are mostly linked with the enlargement of the European Union. Therefore, strong interconnections between local institutions and institutions in Western Europe are going to be stronger in Slovakia (which joined the EU in 2004) than in Ukraine, where there is no short term perspective of joining the EU (see Sellar and Pickles: 2002).

[32] Instead, Ukraine is beneficiary of the 'EU neighborhood Policy' which involves economic assistance, includine access to the Tacis program. EU Neighborhood Policy: http://ec.europa.eu/world/enp/index_en.htm (access: 2007-03-06)

6.2.2 Firms operating in both Slovakia and Ukraine

Micheal Dunford has discussed at length the rise and fall of the large Italian, Turin based clothing conglomerate GFT (Dunford: 2006, pp. 46-49). Since the mid-1980s, GFT established know-out contracts overseas, according to which GFT technicians re-organized other firms' factories bringing in their own methods and standards. In one of these contracts, in 1987-1989 GFT re-organized the production of the large Czechoslovak firm OZKN, the largest clothing producer in Eastern Slovakia in socialist times (see Smith: 2003 for a discussion of OZKN). Immediately after the collapse of State Socialism, GFT attempted unsuccessfully to acquire the main OZKN facility in Presov. Instead, with the support of former OZKN managers, in 1992 they proceeded to acquire a large facility, formerly a branch plant of OZKN, in Svidnik, which was constituted as a Slovak legal entity named SVIK, 60% owned by GFT and 40% owned by the local people who had supported the investment. Over the years, GFT extended its ownership to 97% of the facility, and the remaining 3% is still owned by one of the four original Slovak partners. As in the case studies discussed in the previous chapters, a combination of pressure on the Italian market and opportunities offered by Eastern Europe determined the investment. GFT decide to acquire a factory abroad because:

> It had its own brand, 'Facis,' still existing. Then it added Armani, Kelvin Klein, Valentino, and some other minor brands. It was a holding, with its own brand, plus shares in the others. It produced the apparel for Armani, KK, and Valentino. Those brands kept being produced in Italy because of the high price margins. Instead, as far Facis, it had to go out of Italy. (Interview technical director, SVIK: 06-28-06).

The geographical choice of the investment was based on the networks established through the know-out contracts. A combination of local tradition and opportunities arising from post-Socialist privatization led GFT to both Slovakia and China:

> The quality of our product is medium high. It wouldn't have been possible to do such products in Egypt, because there wasn't the basis to achieve such quality. Also, I am not sure whether or not it was possible to make acquisitions in other countries. I know that there was cooperation with Jordan, but not an acquisition. That was already a private plant. Instead, in Eastern Europe they were privatizing (it could have been here or in Poland, but Poland was already much more expensive), Slovakia already had tradition in clothing; in OZKN there were forty-fifty thousand workers. It was done the same as in China. Also there, when they began to privatize, GFT bought the 41% of a factory; they couldn't do more than that in China. (Interview technical director, SVIK: 06-28-06).

Over the years, SVIK grew, and survived the collapse of the GFT group:

> In 2002 GFT closed. The cooperation with Armani and KK was terminated; Valentino was sold to the Marzotto group. It remained Facis. The plant in China was sold, and the brand Facis plus the factory SVIK was acquired by Mediconf.
> Mediconf had in the beginning Gifrab (shirt producer, with the factory in Bulgaria), Facis (the brand), SVIK (the factory producing for Facis), and a chain of retail stores.
> Since 2006 Mediconf split, it remained with Gifrab, keeping all the military production; at the same time HCB was constituted, it controls Facis, SVIK and the retails. (Interview technical director, SVIK: 06-28-06).

Looking more closely at the ways in which SVIK evolved in its almost fifteen years of activity, a progressive technology and organizational transfer emerges:

> The plant was re-structured, because it didn't respond well to the needs of our kind of production. The personnel didn't change much, but the organizational structure was changed. We brought the Italian organization. I don't know how it was organized before. However, some previously not existing professional categories were brought in. Besides our kind of productive cycle, we brought in the piecework system. In sum, we made a copy of the Italian plant. I arrived after five years, and there was no difference with respect to an Italian plant…. [When I came, five years later] We changed the products, nearly doubled the employment, and, with Mediconf, we added a few more things. When I came, 60% of the work had already been done. At that time, this was already a copy of an Italian factory. It was one staff department, doing CM production. Now it is a full-fledge factory. The only thing missing is design, but there is the development of models, automatic cut, and storage, everything… Only

design, sales and the administration of Facis are still in Italy. (Interview technical director, SVIK: 06-28-06).

Among the most important consequences of this process is the increase of the quality of labor. By now, complaints about the quality of labor are a memory of the past:

> When I arrived there were serious problems concerning the personnel, we couldn't find enough people to work. There was a strong competition from the State, that paid unemployed people a subsidy valued 60% of our salary. …. Then the law changed, there were fewer subsidies to unemployed, and automatically more people came to work.
> For sure, in the beginning they had problems with the manpower, because the mentality is different, the intensity of work was lower. *I heard about it, I didn't experience it*. (Interview technical director, SVIK: 06-28-06).

The further steps of the evolution of SVIK provide a concrete example of the forms of spatial interdependence of the Italian textile and clothing industries described by Micheal Dunford (2006). Notwithstanding the changes in ownership, the management of design, sales and the establishment of backward and forward linkages has been always controlled in Italy:

> We produce jackets and trousers. We receive all inputs from Turin. Turin sends cloth and the 'inner part' – i.e. everything that is inside a jacket. We produce the apparel, and we sent back the finished product. SVIK adds only the yarn and accessories. In sum, we do OPT production for the parent company only. The only exception is that we do a few jackets for the other owner, because 3% of SVIK is still owned by a Slovak person. But this happens only once in a while. The final product is sent to a warehouse in Turin – this is outsourced as well, it doesn't belong to Facis - and from there it is distributed among the buyers… The cloth and the lining are not produced by Facis; they are bought by the office of Turin… [The fluctuations in the market] are managed in Italy. Facis has some long term customers among stores, plus some wholesalers. During the time in-between seasons, when the demand is low, they use these wholesalers. In this way, they guarantee work for us. (Interview technical director, SVIK: 06-28-06).

Instead, as described above, the production has progressively shifted from Italy to Slovakia. However, by the mid 2000s SVIK began to respond to the growing cost pressure in Slovakia adopting the same strategy that had been adopted by manufacturers in Italy in the early and mid 1990s: increase in the quality of the domestic production, and outsourcing abroad of the low end products:

> Here is happening what used to happen in Italy in the past: wages are growing without giving anything back to the industry (like lower taxes, longer hours, etc.). Here every year wages have a five-six percent growth. This means that in a few years Slovakia will have the same problems as Italy... For sure, in the future we will have problems, the same that happened in Italy. For this reason we are beginning to go to Ukraine. Here wages are growing, the crown is re-evaluating. Because [of exchange rate], we lost 20% of income [since] 2004… [In Slovakia] we are following the pattern of development of Italy: we are trying to optimize our work. If before we didn't think much whether to do something or not, because the wages were lower, now we are trying to use the personnel at best. We are also investing on the improvement of machinery. At the same time we are beginning to move to countries were labor cost is lower, like Ukraine. (Interview technical director, SVIK: 06-28-06).

The outcome of this strategy has been the constitution of a new firm, a Ukrainian legal entity called TexUcraina, a brownfield investment located in the City of L'vyv, producing trousers. Looking at the ways in which SVIK ownership got involved in Ukraine, the following issues emerge. First of all, the pattern identified by Kalantaridis (2000) and Smith (2003) finds an empirical validation in the case of SVIK-TexUcraina. The two authors argued that central European (Slovak and Hungarian) actors have mediated the inclusion of Western Ukraine in the global textile value chains. In this specific case, the Slovak minority shareholder of SVIK arranged the mediation through his own personal network. The Ukrainian director of TexUcraina describes the situation as follows:

> SVIK Slovak director is friend with my father. They had been talking for a long time of investing together. They wanted to optimize [SVIK] production gaining the advantages of Ukrainian cheaper labor.
> They decided to invest in the L'vyv region. First of all, he trusted my father (who is from here); he knew that with him he would have avoided many problems that always arise when you go to invest in a different state. Then, L'vyv region is close to Svidnik, and it is better than the other region on the Slovak border, Zakarpattya. Zakarpattya has much more migration, therefore there are labor shortages there….
> The Slovak and the Italian directors of SVIK came regularly here; sometimes for two or three days each week, and traveled with my father to look for sheds and to negotiate with the owners. I was always present at the negotiations, as lawyer and trustworthy person. They

> came regularly for half year. The final decision was sanctioned by the Italian headquarter of Mediconf [The company owning SVIK between 2002 and 2006], but the two of them did all the work. (Interview general director, TexUcraina: 07-14-06).

Second, with reference to the ecological model of Italian investments in Eastern Europe described in the previous chapter, the case of SVIK-TexUcraina shows the ways in which this model works in its peripheral areas. Because of its high sensitivity to the cost of inputs, the apparel industry is likely to establish contracting relations and investments in areas still peripheral for the bulk of Italian investments overseas. The case of SVIK shows how the cost-opportunity structure of this firm privileges the cost of inputs over the convenience offered by the presence of Italian banks, service firms, entrepreneurial associations, and a more regulated EU environment. SVIK is a paradigmatic case of this trend: it established in Slovakia in 1992, pioneering Italian investments in Eastern Europe; it set up TexUcraina in 2003 (2004 it started to produce). Both in 1992 and in 2003 the investment had to face similar problems due to the absence of established support structures. In both cases, the firm responded to these challenges by including local, influential, people in the investment:

> There is nothing there. We did everything by ourselves, with the help of some friends: a Slovak man (who has a few shares of SVIK) and a local politician. The two were friends, and this Ukrainian person got 3% of the shares of the new company. On a smaller scale, we did the same things as in Slovakia, including local people in the company. Then there is lawyer, son of this politician, who is the director.
>
> Without consulate, we should have gone to Kiev [for support], but it is too far. GFT already did some feasibility studies on Ukraine ten years ago, where it showed that the center of textile industry is in the East of the country. It is too far.
>
> This lawyer helped us with the laws, but it is a mess … We have no help.
>
> However, if you go there without local support, there are lots of problems. If you have a local connection, it becomes a little easier.
>
> There we have a general director; a director of production, then the quality control is done by a Slovak who speaks Ukrainian, who already worked with us. (Interview technical director, SVIK: 06-28-06).

Finally, the more convenient labor and input costs of Ukraine are counter-balanced by higher transaction costs:

> [In Ukraine] the labor cost is much lower than Slovakia, but there are other kinds of problems to make life difficult. For example, there is a 12% custom tax on the export. We work in OPT trade, so we don't pay VAT, but we pay a 12% tax when we bring the goods out of Ukraine. Also, in this moment the country is a mess. There are huge problems there, there is the same old elite trying to get advantages for themselves… Then, there are no services there. Industry needs services. There, the roads are scary. Also, our factory there works on two shifts. Public transport there starts at seven, and end at nine thirty. The factory works from six to ten, so you have to bring the people in. They give you water when they want. Then bureaucracy is very complicate, with crazy requirements. They asked us a certificate to show that sewing machines are not radioactive!
> …. We have been there for two years; it has been a quite traumatic experience. We are going through the same experience we had in Slovakia, in terms of scarcity of personnel. There is the same law over there: who stays at home has a little allowance from the state; thus they don't come to work. We have a plant there which should have one hundred, one hundred and five employees. We are eighty two and cannot get higher. All of this happens in a city with a population of 900 thousand! And we can't find fifteen employees! The employment bureau doesn't exist; it is difficult to find contacts with people. Costs there are still low, but they are growing. The salary of workers doubled in one year and half. We started with sixty dollars a month, now we are around one hundred and fifty. Some time ago, gas was extremely cheap, now costs half than here. They told me that foodstuff increased as well. (Interview SVIK: 06-28-06).

The firms located at the border region of the European Union, which, in the case of Slovakia, correspond with the border between the areas of established Italian presence, face this trade-off between labor and transaction costs. The medium to small garment producer AA[33] established a factory in Eastern Slovakia in the year 2,000. A combination of macroeconomic and sector conditions, together with the availability of Italian services, led AA to Slovakia:

> We asked a consultant to do analysis of the area. We considered Slovakia and Romania. From that research we learned that Slovakia has higher wages than Romania. However, productivity here was higher… [Enough that it] offsets higher costs. Another important aspect of Slovakia is the low rate of absenteeism, which was a quite widespread in Romania. We had a little absenteeism in the early years, and I was told that it was due to the harvest. People didn't go to work during that time, because the State protected them, by supplying their wages. After a

[33] Name omitted under IRB agreement.

> few years, that problem disappeared. The second very important reason why we came to Slovakia is because of the excellent work of the Italian consultant. (Interview entrepreneur, AA: 07-09-06).

As often the case, AA chose the concrete location of the investment based upon a personal relationship of trust with a local person:

> We came to this town because we knew Suzana [who is from here]. She was our interpreter when we worked with subcontractor, we trust her, and so we decided to open here. It is a good location, because it is close to Hungary and Ukraine, and it may be a good logistic node in case we decide to further expand in the region. (Interview entrepreneur, AA: 07-09-06).

Later, in 2004 AA decided to set up a twin plant in Ukraine. In this case, the choice was not due to save on labor cost only, but on the creation of a flexible system of production capable to offset the growing variability in demand:

> We took this decision because in the last few years wages in Slovakia are growing and because the value of the Slovak Crown over the Euro increased.
>
> At a certain point, we needed to increase our productive capacity. We had two options: either to increase the number of employees in Slovakia, or open a new factory beyond the border, thirty km away from here. We considered the cost per employee, in Ukraine it is 50% of Slovakia. Also, Slovakia is expected to adopt the euro in 2009, thus we decided to go to Ukraine.
>
> ... There is a strategy behind the choice of going to Ukraine, to address the current high uncertainty in the market, because of China and East Asia in general. Going to Ukraine in this moment doesn't mean to decrease the production costs, but to support a possible decrease of the orders. If we have one hundred employees in Ukraine, it costs as much as fifty in Slovakia. Thus, when I need all one hundred to produce I will use the Ukrainian facility; when I will need just fifty, in the end I will have the same costs as in Slovakia. Since my goal is to keep costs constant, I will be able to pay salaries to 50 more people when the demand is low, to have them ready to work when the demand is high. (Interview AA: 07-09-06).

As in the previous SVIK example, AA Slovak director has been a key figure in the Ukrainian investment; however, this involvement did not completely offset the higher transaction costs, due to the absence of established Italian services in the region:

> Our Italian owners decided to start up a new factory in Ukraine. …Both the owners and I are in touch with the Ukrainian managing director, who does not speak Italian. The owners are also in touch with the Italian vice-consul. I spent many years [doing business] in Ukraine … To work there you must stay there all the time. It is not like in Slovakia. Here you can trust people, in Ukraine you can't. (Interview AA Slovak Director: October 2005).

> Honestly, we went there quite blindly. The start up phase was quite complicated, because we didn't have the kind of support from consultants as in Slovakia. The bureaucracy is very difficult, the country can't be compared with Slovakia, but the cost per employee is very interesting. We have already done five missions there [we established the factory] and we are adopting the same start up method. (Interview entrepreneur, AA: 07-09-06).

6.2.3 Domino Effect or a more articulated story?

In sum, the two case studies considered show the combination of two general trends in Slovakia. First of all, the firms that moved to Slovakia in the early 1990s displayed a growing involvement in Slovakia: starting from the low end products, over the years Italian garment firms shifted progressively the higher end of production into Slovakia. The very high quality of the local labor force has been repeatedly quoted in the interviews as one of the reasons why this process has been possible. At the same time, the provision of Italian speaking services and banks improved over the years, as the overall stability of the country through the EU accession program firs, and EU membership after May 1st 2004. However, this sharp improvement in business environment and quality of labor has been matched with a sustained growth of inputs costs, which is currently pushing out of Slovakia the low end products. The General Secretary of the Italian-Slovak Chamber of Commerce summarizes the situation of the Italian clothing industry in Slovakia as follows:

> There are a few interesting examples of [clothing] companies which arrived here in the early 1990s to produce the low end products, that were unaffordable in Italy. They progressively established new competencies. Those who were able to work well on the training of their personnel increased the skills of the local manpower. In other cases, they found areas with tradition in that sector, high productivity of labor and better skills than elsewhere in Eastern Europe. Those companies achieved excellent results. Now, low end products, where labor costs are 70-80% of the overall costs, are unaffordable even in Slovakia, because salaries are 250-300 euros per month. Countries where the cost of labor before taxes is 100-150 euros per month are much more competitive than Slovakia. I speak mostly of the center and west

> Slovakia, because in the East there are still areas where real wages are close to the minimum wage, which is 180-200 euros per month. Thus, there are examples of companies which stopped producing the low end here, and moved the high end here, that ten-fifteen years ago was done in Italy. Also, they further de-localized the low end to countries like Romania or Moldavia, moving up to China (although I don't know anybody personally). This mean that Slovakia today can achieve the same quality as Italy fifteen years ago, but it lost competitiveness in the low end clothing industry and manufacturing in general, where the labor cost is the most important issue. (Interview general secretary, Italian-Slovak Chamber of Commerce: 07-06-06).

However, the case studies reported in this chapter show a more articulated phenomenon than the simple disinvestment from the expensive Slovakia towards cheaper locations. First of all, Slovakia has a high quality of inputs and infrastructures at a cost of inputs still much lower than Western Europe (albeit rapidly converging). This provides a significant competitive advantage, even in a cost sensitive sector as the garment industry. Second, the case studies analyzed show how the disinvestment towards lower labor cost areas does not happen abruptly, but as a part of more complex strategies geared towards maximizing the advantages of both higher-wage and more established areas in Slovakia and lower wage, but higher transaction cost in Western Ukraine. The owner a large Italian garment production facility in Eastern Slovakia summarizes this maximization strategy as follows:

> We have a small productive unit in Ukraine, with twenty or thirty employees, one hundred and fifty kilometers from here. We have no plans for the other areas.
>
> It is not only a matter of costs. Who runs after costs only will never stop. Instead, you need to have more kinds of product, differentiating the investment, and increase the quality. You need also to offer services: the dyeing is a service.
>
> We don't plan to move from Vranov. We need to find new solutions, like this small unit in Ukraine, to begin to move some kinds of production, to be able to keep the structure here, because here costs are growing very fast. Gas, electricity, fuel now is as expensive as in Italy. Labor cost is growing too. Labor costs now ten times than in 1992. Another problem is that the value of the crown over the euro grew. This mean that keeping wages constant, the price we pay for labor grew of 20%.
>
> In this moment we do not have plans to shift production from here to other countries. What we did so far was aimed at increasing production. So far, we never establish new factories to close the old ones. (Interview entrepreneur, Mis Slovakia: 07-14-06).

Last but not least, the shift towards the Ukraine and other non-EU areas is one among several strategies Italian garment firms have adopted to cope with the changing conditions in Slovakia. Other possible strategies include the counter-trend diversification, i.e., shifting part of the production towards higher wage countries, and the decision of not moving from Slovakia, but in the context of a broader firm strategy. An example of the first strategy is a large manufacturer located in Hummenné (Eastern Slovakia). Since the start up in the year 2000, the Hummenné investment has been very successful, to the point that the facility is approaching its structural peak of profitability. Because of this, the firm is considering a new investment:

> We are establishing here very well, and costs are still ok. We think this will be the case for another three or four years, until Slovakia will adopt the Euro; therefore we still have a few years of development ahead of us before moving. Instead of moving, our plan is to split the company, because it already reached its peak of profitability. After a certain threshold, if you increase the number of employees, profitability decreases. It is better to have two factories with four hundred workers than one with eight hundred. In our case, we will split the most special processes and products from the ordinary, and will start up another factory. One of the reasons is that space here is limited, and we can't expand the shed. However, this is not the most important reason; the key is that we understood that it is easier to manage and less dispersive to split instead of having one very large factory. Besides this, the market here is saturated, and we can't find new employees. (Interview technical director, VSK (2): 06-23-06).

At the moment of the interview (June 2006), this decision hadn't been finalized yet, but the management was considering another option. Instead of shifting the low end products in a lower wage country, the most likely plan was to keep the baseline in Slovakia, and shift the higher end product in a higher wage, but closer to the Italian market, area, in order to maximize the advantage of short delivery timing:

> Q.: Do you already know where you will open?
> A.: Not yet. Most probably we will choose an area closer to Italy – one example could be Croatia. – Going closer to Italy wages are higher, but it will be manageable because we will

> produce high end products, with higher value added; therefore, the relation between costs and earnings will remain constant.
> For sure, we don't have plans to move neither to China, nor Ukraine. As far I heard Ukraine is still quite experimental: they are doing something, but you need some connections to get in. We did some attempts of commercial penetration, but they weren't successful. (Interview technical director, VSK (2): 06-23-06).

An example of the second strategy is Mario Boselli Group, whose internationalization has been thoroughly discussed by Micheal Dunford (Dunford: 2006, pp. 54-56). The group established a synthetic yarn production facility named Twista in Hummenné in 1998-1999. At the moment of the interview (06-28-06) the group did not have plans to establish other production units outside Hummenné. Behind this choice of stability there is first of all the high cost involved in moving yarn production, which is much higher than apparel-assembly facilities as those discussed above. The choice of staying in an increasingly expensive Slovakia has been made notwithstanding the expiration of the MFA and the effect increased Chinese competition has on the costs and demands of some of the group's products:

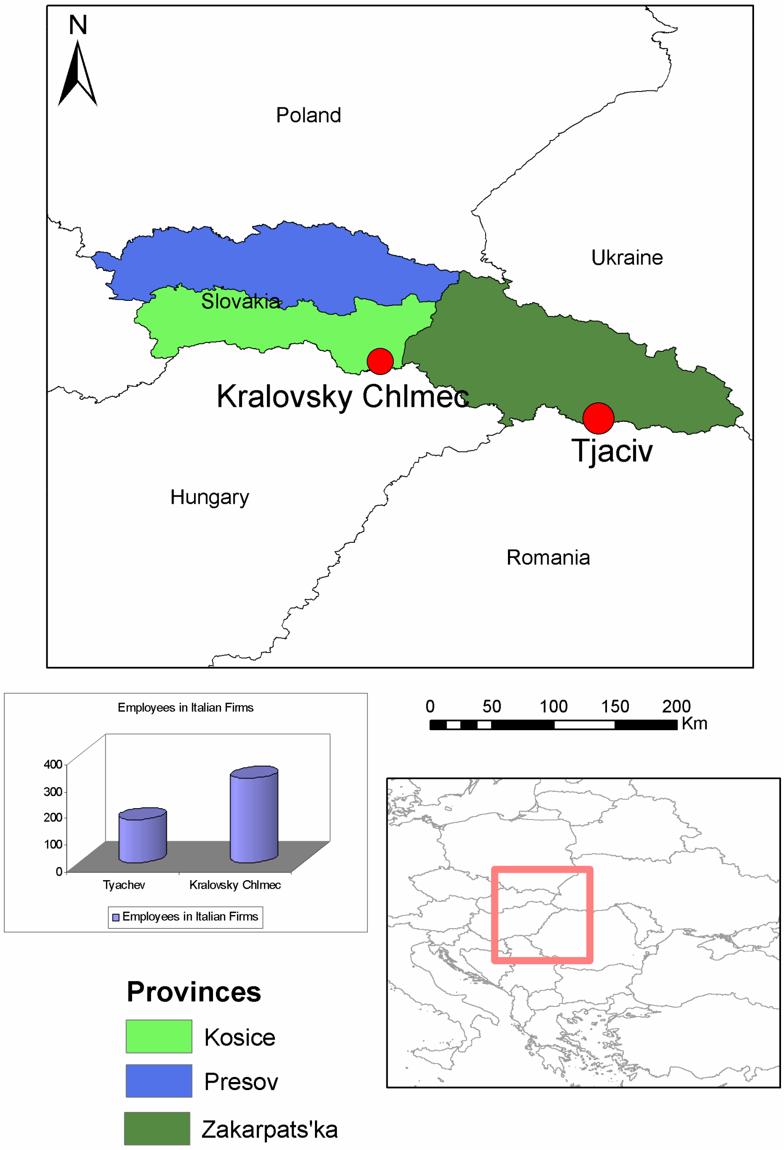
> The [expiration of] MFA created strong unbalances in our sector. For example, we used to sell yarn in Poland to produce very light cloth, which can be used to make curtains, or wedding gowns. The cloth is quite specialized, but the yarn is not, it is a standard product. When the MFA expired, the price of this yarn dropped from three euros to two fifty, while the price for the raw material didn't change.
> In general, both the prices and the demand of the basic yarn dropped. For example, we had three or four standard, non specialized products and we used to produce 80 to 90 thousand kilos per month of them; now we produce less than half. The prices dropped because of the import of Chinese yarn; the quantity dropped because some of those who used the yarn to produce low quality cloth for internal use are now importing from China. (Interview general manager, Twista: 06-28-06)

Instead of investing in a region where wages are lower than in Slovakia to contain costs, the group is responding to this challenge combining product diversification with a creative engagement of its Chinese competitors:

Q.: How do you respond to this challenge?
A: We went to look for a higher value added market. We produce special yarn; instead of producing yarn of viscose and nylon only, we use also polyester, acetate and mixed products. We are still producing common yarn, because we produce such large quantities, that there would not be enough demand in the market for special yarns. However, we are shifting to special products as much as possible, and this is the reason why we are keeping in an R&D center in Italy… [Notwithstanding Chinese competition] this year we had a 25% increase of production with respect to the first quarter of the last year, with the same machinery. This is probably due to the fact that the offer from China is somewhat decreasing, because the Chinese market is growing. Then also China will become a market. We are already selling a special yarn, very shining, that is needed to produce labels, to a factory in China.

Q.: Does the Mario Boselli group have plans for further internationalization?
A.: We want to stay in Slovakia, because to move such a large factory is expensive. As far China, we are establishing a few joint ventures with Chinese companies that produce silk, linen and cloth. We import their cloth to Italy and we do there the last phases of production of the cloth. We prefer this to establishing a factory there, because to travel back and forth, and send technicians there is very difficult, and it is risky to let local people manage without supervision. (Interview general manager, Twista: 06-28-06).

MAP 6.1: Employees in Italian firms in Kralovsky Chlmec (SK) and Tyachev (UA)



6.3 The relationship between Italian firms and local communities: the case of Kralovsky Chlmec (Kosice Region, Eastern Slovakia) and Tyachev[34] (Zakarpattya Region, Western Ukraine)

6.3.1 Two different paths of post-Socialist transformation

This section explores the different ways in which Italian firms and local communities engage each other in Eastern Slovakia and Western Ukraine. To do so, it compares two towns in which Italian firms and joint ventures with Italians grew to the point of providing a relevant share of employment in manufacturing. The analysis moves beyond the textile and clothing industries, considering the ways in which the structure of the manufacturing sector of the two towns has changed since 1989. The interpersonal and institutional networks determining the transformations are described. The two towns are Kralovsky Chlmec in Eastern Slovakia and Tyachev (plus surrounding villages) in Western Ukraine. Tyachev and Kralovsky Chlmec are two small towns of similar size: Kralovsky has a population of 8 thousand, Tyachev around 12.5 thousand. Kralovsky is located near the triple border between Slovakia, Ukraine and Hungary, sixty kilometers from the regional capital Kosice; Tyachev is on the Romanian-Ukrainian border, around one hundred and thirty kilometers South-East of the Regional capital of Zakarpattya, Uzhgorod (Map 6.1).

Table 6.1 summarizes the structure of the economy in the two towns – as it emerged from interviewing the local mayors – in the beginning of transition and 2006. ‘Beginning of transition’ is considered the collapse of the USSR for Tyachev (1991) and the ‘Velvet Revolution’ (1989) that signed the end of the Communist regime in Czechoslovakia for Kralovsky. They have three important features in common: first of all, the importance of

[34] Other spellings in English are Tyachiv, Tjachiv and Tyachevo.

Italian firms or joint ventures with Italians, which account for 10% of employment in manufacturing in Tyachev and an impressive 80% in Kralovsky Chlmec. Second, the table shows the extremely harsh impact of post-socialist transformation on local communities: in both cases, *none* of the enterprises providing manufacturing jobs during the past regime is still functioning after fifteen years of market economy. In both cases, the renaissance of manufacturing depends heavily from foreign investments. While in the Slovak case there are still three local firms with a significant number of employees (a subcontractor in the garment industry and two spin offs of the old state owned furniture producer, plus a handful small firms that my informants did not know well), in the Ukrainian case the dependence is complete. Third, manufacturing employment and firms' size is significantly smaller in post-socialist than in Socialist times.

Table 6.1 Structure of manufacturing in Tyachev (UA) and Kralovsky Chlmec (SK) in the beginning of transition and in 2006.

Sources: local mayors, interviews

Tyachev

	1991		2006	
Sector	**Facility (name, activity)**	**Employment**	**Facility (activity, origin)**	**Employment**
Manufacturing	Zenit – Radio and electronic equipment for defence and space industry	1,600	Italian clothing factory	160
	2 wholesale stores	n/a	Hungarian clothing factory	n/a
	3 construction firms	n/a	Ukrainian/Belarusian joint venture – wood processing factory	n/a
	Total employment in manufacturing	5-6,000		1,500
Services	n/a		Bars, restaurants, 'kiosks'	3,500-4,000
Remittnaces from migration (pemrnanet and seasonal)	None (migration restricted under Soviet Law)		20% of workforce	

Timeline of transition in Tyachev

1991-1995/6	1995-2003	2003-present
Contraction and closure of the State owned firms	Emergence of small commercial firms	Foreign investments and joint venture

Table 6.1 (cont'd)

Kralovsky Chlmec

	1989		2006	
Sector	**Facility (name, activity)**	**Employment**	**Facility (activity, origin)**	**Employment**
Agriculture	1 State owned firm	1,000	n/a	
Manufacturing	1 metal mechanic complex 'A' (ovens + reels)	200	Italian-Slovak JV, ovens (Spin off of A)	16
			Italian-Slovak JV, reels '1' (Spin off of A)	70
			Italian, reels (Spin off of '1')	150
			Italian-Slovak JV, equipment for agriculture	20
			Italian-Slovak JV, alcoholic beverages	16
			Italian, garment producer	45
			Hungarian, metal-mechanic	15-20
	1 woodworking factory 'B' (furniture)	600	2 Slovak furniture producers (spin off of 'B')	40
	1 construction firm	100	Slovak garment producer (subcontractor for a German firm)	250-300
	Total employment in manufacturing	900	Total employment in manufacturing	650 (+-55)
services	Town services	150		

Timeline of transition / establishment of Italian firms and Italian-Slovak JV

1990	1992	1997	1998	2001	2004
Italian-slovak oven producer	Italian-Slovak reel producer	Italian-Slovak alcoholic beverages	Italian-Slovak equipment for agriculture	Italian garment producer	Italian reel producer

Looking at the timelines of post Socialist economic transformation in the two towns, it emerges clearly that the later inclusion of Western Ukraine in international value chains concerns not only the apparel, but other industries as well. Particularly, in Kralovsky foreign (Italian) investments began to come at the very beginning of transition (1990), while in Tyachev foreign firms started their activity in the early years 2,000. This decade time lag over the attraction of foreign investors has had an important impact on the structural changes of the local industries. In Tyachev, in ten years of absent or insufficient investments the socialist industries died out completely; for more than five years between the mid Nineties and early years 2000, there was almost no manufacturing production. The new investments have no functional relationship with the Socialist factories, and this led to important changes (and downgrading) in Tyachev's industrial base, which shifted from being based around one formerly high tech large electronic facility, to the apparel and wood processing sectors. The relationship between the old and the new industries consists in the brownfield character of some of the investments, because the Italian garment factory occupies the space of the old Socialist electronic facility.

Also in Kralovsky the new factories occupy the spaces of the socialist industries. However, the early injection of foreign capital and the inclusion in the value chains of Italian firms preserved part of the pre-1989 industrial structure. Kralovsky industry was, and still is, centered around metalworking manufacturers: industrial downgrading did not take place. Moreover, three of the Italian or Italian Slovak industries are direct or indirect spin offs of the Socialist metalwork enterprise; at the same time, from the large Socialist wood processing enterprise two small firms span off. Therefore, many of the previous professional skills were maintained and refined in the new system, making the whole transition less dramatic for the local community.

6.3.2 Kralovsky Chlmec, Eastern Slovakia

Looking at the ways in which the two towns undertook these two different paths of transition, two factors emerge: first, the establishment of international professional connections by managers of the local industry; second, the entrepreneurial skills of the local intelligentsia emerge. In Kralovsky Chlmec the creativity of the local elite in attracting Italian firms has been such, that it was written up in a national newspaper.[35] By the end of 1989, Kralovsky had a non-competitive, but intact, metallurgic industry that had just lost the Soviet market. There was also no experience of market economy in the working age population, with one exception. A local child doctor – Dr. Stefan - had the chance to travel abroad as expert for the World Health Organization. In so doing, he learned English, visited capitalist countries and got acquainted with entrepreneurs. The story of the Italian presence in Kralovsky began with an alliance between this pediatrician and the then director of the metallurgic plant, who with and few others (including the former mayor of Kralovsky Chlmec) went to Italy to look for business partners. These people tell the following story about the initial steps of Italian presence in Kralovsky:

> I am a pediatrician. I am a WHO expert. Working for the WHO, twenty years ago I was sent to Malta for a five years internship as assistant pediatrician at the University of the St. Lux Hospital. There I could experience a country that at that time was developing, but under the capitalist system. There I had the first contacts with entrepreneurs. Soon after I went back home, in 1989 a new life started. …Also in a small town like ours, with 8 thousand five hundred people, the changes brought consequences. We lost the Soviet market, they didn't buy our products anymore, and all the industry collapsed, because we had neither the quality nor the products to sell to the Western markets. We didn't have the financial means to start new activities with new technology neither.
> To start any kind of [entrepreneurial] activity here we needed: first, technology, and second, the markets. Since we had none of those, we turned to foreign companies. Here we had tradition in reels, and we produced low quality ovens for bakeries. Thus, we contacted the first company in Italy, which produced ovens for bakeries. We went to visit them, and then they came here… We took a brochure in a fair, and we called them. In the beginning we spoke English. After a couple of phone calls, they came here to see the plants, equipment and machinery.
> Then a joint venture was established, in the form of a joint stock company. This legal form was the only possible in Slovakia at that time. Only later limited liability companies and other legal forms were recognized by the Slovak law. By now, the best and more flexible legal form for SMEs is the limited liability company. (Interview Dr. Stefan: 07-09-06).

[35] "Kralovsky Chlmec hovorì po taliansky" [Kralovsky Chlmec speaks Italian] *Trend*, January 22, 2004.

> There are no official relations between Italian companies and the town's administration. However, there are contacts because this is my fourth year as mayor, but before that I worked since 1992 with Italian entrepreneurs. In August 1992 we went, four people in one car to Italy… there was the company …, which produces reels, from very small to big sizes. There we established an Italian-Slovak joint venture (Interview mayor Kralovsky Chlmec: 07-06-06)

Over the years this experiment in attracting Italian firms grew with remarkable success. First, the good reputation of the old Socialist reel producer helped to attract the early investments:

> The Italian company knew us since Socialist times, because the Czechoslovak company was their direct competitor. This is the reason why they wanted our company and its technicians and skilled workers. We also had an empty factory where we could start to work immediately (Interview Dr. Stefan: 07-09-06).

Second, through these early investments Kralovsky's intelligentsia entered into the informal networks upon which so much of the Italian investments are decided:

> After [the first joint venture], an Italian entrepreneur …, interested in producing reels called me That company is the largest producer of reels in the world. I got this contact through [my first Italian business partner]. They called me, and we decided to meet halfway, in the Vienna airport. There, we agreed to establish an Italian-Slovak limited liability company. (Interview Dr. Stefan: 07-09-06).
>
> It is interesting how the third company started. I was director in [the JV producing reels]; [I had a colleague in Italy], who was responsible for production. We were in touch every day; because each time there was a technical problem here in Kralovsky I called him... He accepted an offer from a friend in Italy, and switched to another company. We had a very close relationship, we were like brothers, and thus he proposed me to start a new company in Slovakia…. So, only because of personal relationship a new company started (Interview mayor Kralovsky Chlmec: 07-06-06).

Third, they understood the need of their Italian partners of 'cultural services,' i.e., Italian speaking labor and bookkeeping in Italian, and provided them:

> The first language of communication was English; then, while the work was growing, we shifted to Italian. We set up Italian classes; we brought an Italian teacher from Kosice [the regional capital] in the company. All the employees were asked to go to class on Saturday

> afternoons and Sunday mornings to learn Italian. Now from the mayor to the lowest level worker, we have around one hundred people who speak Italian at a good level…. Italians saw that here we developed an 'Italian' center, and Italian is widely spoken, and that the bookkeeping is done in Italian. The structure of the bookkeeping for limited liability companies is the same in the whole EU, they all use double-entry bookkeeping. So, we translated all the accounts in Italian. We had two accountants, one Italian and the other Slovak, worked on the translation of the accounts of all companies. Then we develop software to produce on a daily basis the profit and loss accounts and the balance accounts in Italian language. The program is web-based, so our partners from Italy can see the cash flows every day. (Interview Dr. Stefan: 07-09-06).

The Italians agree with this vision of informal networks determining the attraction towards Kralovsky Chlmec:

> This is a Slovak company, owned by three partners, one Italian (me) and two Slovak. Before this, there was a joint stock company, 90% of the shares belonged to an Italian company. I was director of production, I used to shuttle between Slovakia and Italy. Then, the Italian company decided to disinvest, and my partners and I bought it.
> Italians began to come here in 1990, to cooperate with already existing Slovak companies. They met in fairs, and the information spread through an informal pass-the-word. All companies here come from Central-Northern Italy, Parma, Bologna, Brescia. (Interview Italian-Slovak ovens producer: October 2005).
>
> We came to Kralovsky because we trusted Suzana, who is from here (Interview Italian garment producer: June 2006).

In conclusion, the post socialist transformation of the manufacturing industry in Kralovsky Chlmec has been skillfully piloted by a local intelligentsia, which was able to find a way of including the local industry into international – if not global – value chains through the establishment of joint ventures with Italian producers. Because this was understood as early as 1989, the basic structure of the local industry has been preserved throughout the transition period.

6.3.3 Tyachev, Western Ukraine

In Tyachev the demise of the Soviet industry had a deeply negative impact on the town's economy:

> In Soviet times, the economy of Tyachiv was based on one large company – Zenit – in the defense sector. It employed a large part of Tyachiv inhabitants. Moreover, large part of city's government income came from Zenit. It built infrastructures for Tyachiv; it had its own kindergarten, it provided lodging for the employees. It participated to the construction of the town's hotel; one entire floor of the hotel was reserved to Zenit. In Zenit used to work a very strong group of engineers. Besides Zenit, there were two large wholesale stores that served the entire region, one large integrated plant – this was a large employer too -, one processing plant for dairy products and three construction companies. All of this either was closed off, or shrank. This was a big hit for the town's budget, because 80% of it came from those firms.
> In five or six years the economy was entirely changed. Now 90% of town's budget comes from taxes paid by small businesses… As far employment, the five large Soviet companies absorbed 80% of the town's labor, and they hired beyond city borders as well. Contemporary small businesses are able to absorb only a small percentage of their employment. Migration and seasonal work abroad (Czech Republic, Portugal, Italy, etc) are very important sources of income: I can't say an exact number, but I think it is around 20% of the workforce. (Interview Mayor of Tyachev: 07-12-06).

The re-emergence of manufacturing in Tyachev does not have the close functional relationship with the previous industries, as in Kralovsky Chlmec. As for the Italian investment, the re-establishment of manufacturing in Tyachev is due to international professional connections along the clothing value chain. In order to understand the ways in which these connections were established it is necessary to look at the garment industry in the neighboring town of Khust and villages of Vyshkovo and Ternovo, and to their inclusion in the value chains of Italian firms.

In Soviet times, a large firm in the textile and clothing sector, employing more than one thousand people was based in Khust. The post Socialist transformation of this firm is summarized in Table 6.2. In Soviet times, it produced mostly bed sheets and robes for a larger firm in located Moscow (Interview Ukrainian entrepreneur, Ternotex: 07-14-06). Besides Khust factory, that firm had smaller productive units in the surrounding villages, as follows:

> That firm had around one thousand employees; of which around one hundred and twenty worked in this unit. At that time, the Khust's factory received the cloth and the accessories from other Soviet companies: the ministry gave the inputs to each region (*oblast*'), and the production unions (*obedineniia*)[36] distributed it among factories. Khust factory distributed part of the work among the units in the villages, like this one in Vyshkovo. (Interview Ukrainian entrepreneur Vistex Ltd.: 07-18-06).

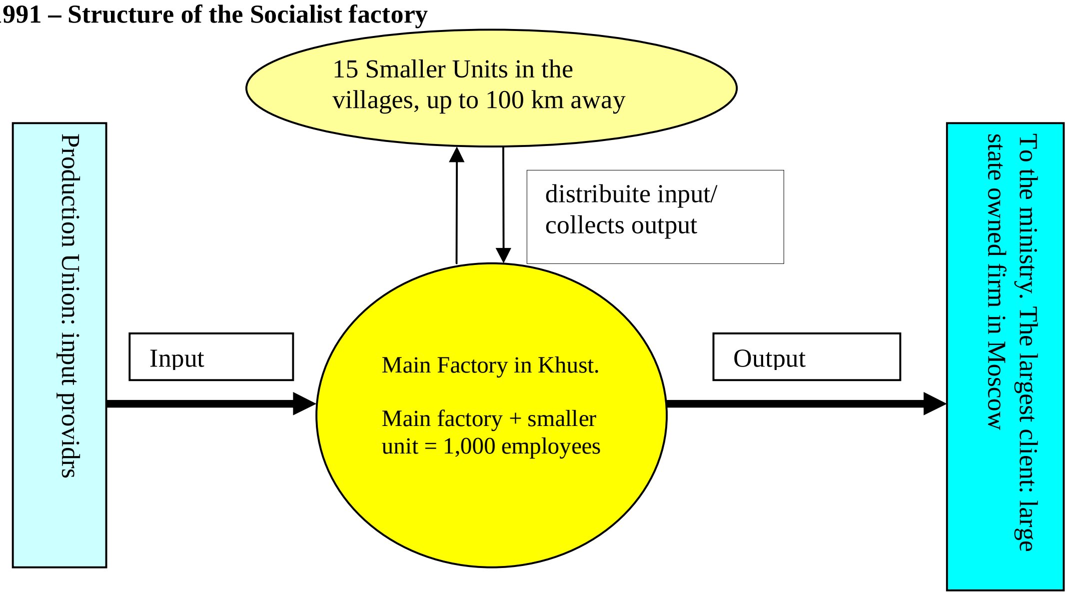
The collapse of the USSR disrupted this firm's work because of the combination of the contraction of the Russian market and the bureaucratic obstacles connected with the emergence of new borders:

> We had been working for fourteen years as subcontractor in a JV with a Russian company. After the collapse of the USSR we kept working with them for a while, but it was more and more difficult, because we had to pay customs and prepare documents. Then we stopped working with them when the Russian market collapsed. We kept all the machinery as payment of the fourteen years co-operation (Interview Ukrainian entrepreneur, Ternotex: 07-14-06)

[36] See chapter 5 for a description of the obedineniia, or production unions: these were fundamental structures in the Socialist economy, and were present in all CMEA countries.

Table 6.2 Post socialist transformation of a garment manufacturer in Khust and surrounding villages, (UA) 1992-2006
Source: Interviews, 2006

1991 – Structure of the Socialist factory



2006 – post Socialist Italian-Ukrainian joint ventures (main product: shirts)

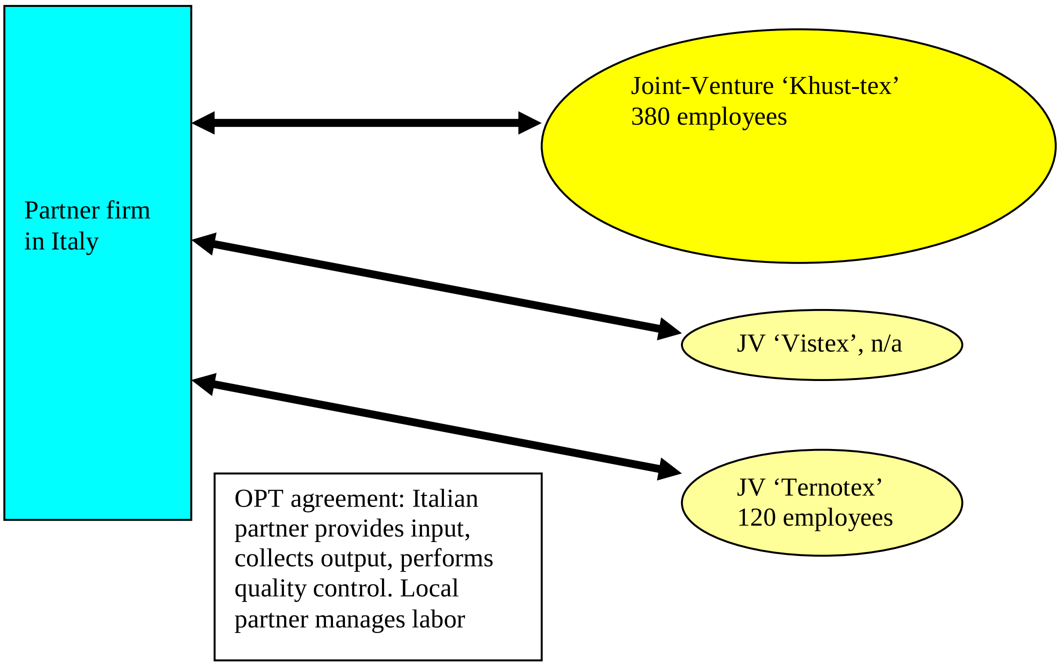


Table 6.2 (cont')

Timeline of the establishment of Italian-Ukrainian joint ventures 'Khust-Tex,' 'Vistex' and 'Ternotex'

1992, December	First Visit; negotiations begin
1993	Renovation of the factory in Khust
1994, February	Khust-Tex begins production
1994, September	The renovation of the factory in Vishkvo begins
1995, May	Vistex begins production
1998, March	Joint venture 'Ternotex' is established

As in the case of the metallurgic industry of Kralovsky Chlmec, the garment firms in Khust and those in the surrounding villages (which became independent from the parent in Khust after the collapse of the USSR) also began to look west for new partners. The firm in Khust and two of its successors in the villages were able to establish three independent joint ventures with one Italian producer, with the help of Hungarian partners. This example is structurally similar to the case of SVIK: the Italian manufacturer had established a joint venture in Hungary. Pushed by growing wages, it partially disinvested from Hungary to set up new joint ventures in Ukraine (interview Ukrainian entrepreneur, Vistex). Unlike the case studies discussed in the previous section, the Italian firm shifted a large part of its production to Ukraine in the early phases of transition: the negotiations to start the first Italian-Ukrainian joint venture in Khust started as early as 1992; by 1998 the establishment of the three joint ventures was completed.

This set of joint ventures has been the beginning of an expansion of the apparel industry in the districts of Khust and Tyachev, which, by 2006, consisted in four large firms and a handful of smaller ones:

> When we started, Khust-tex and we were the only clothing companies in this area. Now there are two in Tyachiv, one in Ternovo, while in Khust there is Khust-tex (it employs 380 people), Evropeiskaia Fabrika, and a few subcontractors. The largest are: Khust-tex,

> Evropeiskaia Fabrika, BB[37] and Avantex (it is in Tyachiv, it is a Hungarian-Ukrainian company). There are a few others, small ones. (Interview Ukrainian entrepreneur, Vistex Ltd.: 07-18-06).

Of the four larger firms (all of them employ more than one hundred) three are Italian, or Italian Ukrainian joint ventures; they all work exclusively as subcontractors for a parent firm in Italy in OPT regime: the parent firm provide the input, and they deliver back the finished product to Italy.

The establishment of the garment production in Tyachev has a direct connection with these earlier joint ventures: the Italian parent firm of Khust-tex, Vistex and Ternotex has a long term subcontracting relation with the large producer 'Alpha.'[38] When Alpha decided to establish a facility in Eastern Europe, it used its subcontractors as sources of information. Once the choice of Ukraine has been finalized, the local subcontractors provided the basis fro the initial steps of the investment. Dr. Marzio Conte (a former scientist with thirty years of experience as high level manager in the industry), supervisor for the Ukrainian investment, describes the decision making process that led Alpha to Ukraine as a combination of rational criteria, such as saturation of the Romanian market, evaluation of the political risk and more personal feelings as follows:

> Seven years ago I came to explore both Ukraine and Romania. When we decided to open a factory abroad, Romania was very popular: close enough to Italy, many companies were already there, the language barrier is not so high. However, talking to Italian entrepreneurs there, Romania didn't convince me: it was already saturating with Italian companies, wages were growing exponentially without any programming, and companies were already stealing each other personnel, which aggravates the increase of costs. Then I came here; there were already three shirt manufacturers in this area and I visited there. I saw it was possible to work, they were the only Italian manufacturers here, and they have been working for three or four years. One of them had some space available, and we agreed immediately. Also, Ukraine wages were three times less than Romania. I saw much more order within those factories than

[37] Real name omitted under IRB agreement.
[38] Under IRB agreement, the name of the apparel firm involved in Tyachev is omitted. 'Alpha' is the fictitious name for the parent firm in Italy; BB for the daughter in Tyachev.

> in Romania. Because of these reasons, it was decided that Ukraine was a better option than Romania to produce without having to compete for personnel and to run after wage increases; Ukraine looked much more trustworthy than Romania to program an investment over a fifteen years period. We evaluated also the political risk, but we didn't give too much importance to it. Our macro-evaluation was that in all countries of the area communism was gone, and all of them were trying to approach the West. Therefore, we considered that [politically] the two countries were equivalent. (Interview Dr. Conte: 07-14-06).

The first step of Alpha involvement in the area had been a joint venture with Khust-tex – starting in 1999 until 2001 - to establish a production line for trousers. The agreement was possible because the large shed inherited from the old Soviet factory still had space available.

In 2001 Alpha decided to expand production to include knitwear, and undertook the first steps to establish a brownfield investment in the old defense industry plant in Tyachev, which hadn't been working for several years, but was still owned by the State company Zenit. Looking at the ways in which Alpha established itself in Tyachev, all the advantages and disadvantages of operating outside the harmonized institutional space of the European Union, which (after the last phase of enlargement on January 1st 2007) coincide with the areas where Italian speaking services are well established. At first, Alpha attempted to constitute a joint venture with Zenit. The project failed due to legal problems, which delayed the beginning of production until 2003. Finally, in 2004 Alpha purchased the shed. Dr. Conte, in leading Alpha investment to Tyachev, perceived an area with lesser pressure on wages and lower competition for skilled labor than the areas in the European Union. At the same time, he worked around the absence of services through informal networks:

> In Uzhgorod there is a business incubator financed by the [EU funded] Tacis Program, whose task is to support foreign companies in their investments in Ukraine. However, their consultancy was limited to show people the available sheds and to suggest local consultants for the implementation of the investment. We had some contact with them, but we didn't use their help because if I need consultants I want to be free to choose them. Then there is ICE [Italian Institute of Foreign Trade] in Kiev. It is too far to be convenient for us, and they don't give a practical support either. Instead, we based on personal connections. I had the name of

> lawyer [who solved the legal problem with Zenit] from an Italian who has a few pizza parlors in Uzhgorod. (Interview Dr. Conte: 07-14-06).

The activation of these informal networks included to work closely with the local administrators, in order to solve the bureaucratic and legal problems raised by the failed joint venture:

> When we had problems in constituting the company, we involved local politicians in the process. We were lucky to meet people like the mayor. He didn't ask any personal favor, because he understands the importance of foreign investments for the town's economy. He gave us political support; he introduced us to the right interlocutors at regional level. He has been very important for us. With people like him we keep having good relationships; with other people we broke the relationship. (Interview Dr. Conte: 07-14-06).

As in the case of SVIK, Alpha tackles the problem of dealing with a still difficult system by appointing directors connected with the local authorities:

> Here corruption is much spread, they often ask favors. The more honest, ask favors for the society, the less honest for themselves. We never wanted to pay bribes, because if you pay once, you pay always. The first time we sent a truck here, with the electric components for the factory, it was stopped for ten days at the border. I came from Italy, went to talk with the head of the regional custom office in Uzhgorod bringing all the documents, and in a few hours the truck passed the border. I was able to bloc this, but it is difficult to let directors accept this, because they are linked to the old nomenclature.
> There is no structure that helps you to select the personnel; also the language barrier is a big problem. Our first director was Zenit's director. After six months he left the position, very angry with 'these Italians, who don't understand anything and want to do things in their own way.' Then we hired the lawyer from Uzhgorod with the task of fixing the legal situation. Then we hired a former manager in the public administration (he was administrative director of a local hospital). He had a car accident, and he nominated a vice-director, who was really incapable. We pressed him to leave the position. Then we had one person from Uzhgorod; he was a thief. This new director is secretary of the local branch of the socialist party, he has the same age as politicians in power, and his wife does audit certification. We managed to give directors only a symbolic position; they cannot do anything in the factory without my authorization. We appoint directors because we do not want direct responsibility against the law, and we want a connection with local authorities. (Interview Dr. Conte: 07-14-06).

However, this does not shield the firm entirely from having to adapt to a fiscal and normative environment which is deeply different from Italy and the EU:

> There is always the rust of the communist regime. The fiscal officers feel they are almighty; employees are in fear of them. Here there is no respect for institutions; there is a holy terror of them. There the tax system is not very good either. We have to pay taxes quarterly, based on cash flows, not on competencies. This means you pay taxes on the cash you have at the end of the quarter, and it doesn't matter if you should use these money to pay something the following month. The adaptation to a liberalist economy requires changing norms, but also mentality and this is a huge enterprise.
>
> People give banks too much importance. They also have control duties on the money they receive. For example, the 30% tax on investments: they are not paid by companies, but by the bank, as soon as they get the money. In the common sense they are perceived as if they were state institutions [people feels a relation of subordination], and they ask for very high commission. (Interview Dr. Conte: 07-14-06).

Finally, in organizing the local labor, Alpha had to face problems linked with the high migration rate, while working to adapt the local tradition to its own requirements:

> Surprisingly, we also had problems of recruiting. Tyachiv is a town of 12.5 thousand; besides us, there only one more manufacturing company, Avantex. Notwithstanding this we have just around twenty employees from the town. We had to buy dedicated busses to bring people from the villages. Avantex does the same. Before starting, we were informed of this situation, but we didn't believe it. Townsfolk prefer seasonal jobs abroad. They go to work to Czech Republic, Russia, and Hungary for three or four months per year and just stay home the rest of the time. Young women prefer to go bar tending, it is not as hard as in a factory. Those are unregistered jobs; they do not pay social security. However, until last year, social pension was guaranteed to everybody, regardless social security payments, therefore people didn't have incentive to work legally.
>
> There is no tradition in the industry: especially as far the knitwear production, they never had it here. … We are giving them the technical skills, while management and cost control is done in Italy. This follows a local tradition in the organization of labor. In Italy, a department head follows both technical and management aspects of its department, while here there are two distinct professional figures: the head of department, who takes care of the organization of the personnel and disciplinary issues; and the *tekhnolog*, who follows the technical aspects of the department, such as the organization of the supply chain, of the productive phases and quality control. (Interview Dr. Conte: 07-14-06).

In conclusion, the establishment of the Italian garment industry in Tyachev is connected with a broader process of inclusion of Western Ukraine in the value chains of Italian producers. In the early 1990s, the first Italian-Ukrainian joint ventures were established in the neighboring town of Khust and surrounding villages, thanks to the mediation of Hungarian partners. The large firm 'Alpha' used the support of these joint ventures to establish itself in the area, at first establishing a further joint venture with them, and later establishing its own investment in Tyachev, re-occupying the shed of the old State-owned electronic firm 'Zenit.' The start up of the investment was slowed down by legal problems, which highlighted the absence of Italian-speaking services and the difficulty of navigating the local institutions and norms. These problems were finally solved through the establishment of personal connections and with help of the local mayor. In starting up the investment in Tyachev, Alpha had then to face initial problems in recruiting, because of the high rate of out-migration, which were solved by establishing a private transport system and accessing to manpower from the villages. In organizing the factory, the different local tradition in industrial organization had to be taken into account, in order to allow the training of the local personnel to the Italian system, in an industrial sector (knitwear production) where there was no previous tradition. Finally, the choice of working outside the European Union had the advantage of lower wages and costs, and lower competition with other Italian firms for labor. At the same time, it had the disadvantage of higher transaction costs because of the lack of Italian services and more 'foreign' organization of norms and institutions.

6.4 Conclusions

The existing literature has highlighted a trend of further relocation of the garment industry from the new member states of the European Union of Central and Eastern Europe, into new peripheries outside the space of the EU. For the Western European firms that have re-located in Central and Eastern Europe in the 1990, this chapter has shown that it is often the case that local partners and employees are an essential component in this process, acting as mediators between their Western European partners and new partners in the Former Soviet

Union and other non-EU areas. Italian firms, which had re-located in Slovakia in the 1990s, are part and parcel of this process. This chapter has also investigated the ways in which Italian firms embed themselves in Slovakia and Ukraine, in order to understand the impact of the EU space on the arrangements between firms and institutions at local level.

From the firm case studies analyzed, a more complex picture has emerged than the usual ‘domino’ theory, where firms disinvest from more expensive areas in Slovakia towards the cheaper labor and cheaper utilities in Ukraine. Instead, firms seem to perceive a set of trade-offs between the two situations: Slovakia provides very well established services, an high quality of labor, very low transaction costs in dealing with the local institutions. The costs of labor and utilities are converging rapidly with Western Europe, but are still significantly lower. Instead, Ukraine has lower costs of labor and utilities (even though growing), but no services and higher transaction costs. In this situation, some firms are trying to maximize the advantages of both countries establishing new investments in Ukraine, but without heavy disinvestment from Slovakia. At the same time, they are adopting different strategies of penetration, in order to cope with the absence of services. The most common is to include local lawyers or politicians as partners in the investment, in order to guarantee a certain shield towards the still difficult as far norms and law enforcement environment in Ukraine.

From the standpoint of the two communities analyzed, it has emerged that the early inclusion of Eastern Slovakia in the value chains of Italian firms had a positive impact on the local industry: in the town of Kralovsky Chlmec, part of the post Socialist firms are direct spin offs of former Socialist factories. Also, manufacturing production and employment in manufacturing has been maintained throughout the transition. This could happen because of the skills of the local elite in attracting the Italian joint ventures. Instead, in Tyachev (Ukraine) the later coming of foreign investments let the local manufacturing die because of lack of capital and access to markets. This condition had a negative impact on the city's economy, and resulted in massive out-migration. In turn, this out-migration creates challenges for the new foreign investments, because creates labor shortages. Also, the new manufacturing does not bear functional relationships with the old one, and this reflects in sector shifts and downgrading (from the electronic to the clothing industry), and in the fact that new professional skills must be introduced.

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Conclusion: the geographies of Italian entrepreneurship in Eastern Europe between value chains and institutional changes

Geographies of Italian entrepreneurship in Eastern Europe

This dissertation has described a pattern of Italian internationalization in Eastern Europe centered upon the progressive intensification of firms' involvement in the region. This intensification concerns first of all the nature of the involvement: in the early 1990s the prevalent forms of economic activities were subcontracting relations and – more in general – productive agreements that did not involve the investment of risk capital. Later, 'deeper' forms of involvement in the forms of foreign direct investments began to appear. Second, intensification came together with sector shifts: small manufacturers in traditional sectors went first, 'opening the ground' to heavier investments in higher tech manufacturing, energy, real estate, services and banking. The case study of Timisoara has shown that there have been also intra-sector shifts in the clothing industry: while several subcontractors are being pushed outside Timisoara because of growing wages and less favorable exchange rate, higher value added services – like the dye works and the embroidery workshop interviewed – are being established in the region. Third, this intensification has both a temporal and a spatial dimension. In the 'mature' areas in Central Europe and Romania – represented by the case studies of Eastern Slovakia and Timisoara – the whole range of conditions described above is present. Moreover, in these areas Italian firms have been established in since the early 1990s, creating well rooted communities of expatriate entrepreneurs and managers, which have been organizing in strong firms associations, like Unimpresa Romania. Bulgaria represents an intermediate situation: large Italian investments arrived after the 1997 financial crisis, attracted by the IMF structural adjustment policies. Since then, Bulgaria attracted a mixed portfolio of Italian firms, from large banks (Bulbank) and manufacturers (Miroglio) to smaller firms. In the years 2000s a new wave of investments has characterized the former Soviet Union and Yugoslavia. The Ukrainian case studies discussed in Chapter 6 present a 'domino effect' from the mature areas in Central Europe into Western Ukraine. In this case, the model is being repeated: manufacturers in the traditional sectors have been moving into Ukraine, with the support of their Central European partners; at the same time, banks and services at the moment of the interviews (late 2005 and 2006) were considering to establish themselves in that area, but had not undertaken concrete steps yet.

The comparative case studies of Eastern Slovakia and Western Ukraine have shown the ways in which the enlargement of the European Union affects this pattern of internationalization. EU membership brings about the harmonization of institutions, norms and law enforcement among the member countries. Together with the established presence of Italian banks and services, this determines low transaction costs to establish firms within the EU. Besides this, in the areas where Italian firms have been working since the early 1990s (as the community of Kralovsky Chlmec in Slovakia, or Timisoara in Romania), entrepreneurs were able to 'educate' local labor to their needs and standards. However, these improvements are matched with growing labor and utility costs, and in some cases (Romania) with less favorable exchange rates of the local currency vis-à-vis the Euro. Because of this reason, the most cost sensitive portions of the textile and clothing value chain (especially the assembly of clothing, CM and CMT production) have been pushed outside the EU area. In Western Ukraine firms are finding the lower wages and utility costs, but higher transaction costs.

Therefore, the prevalent strategy among the firms interviewed is not total disinvestment from Slovakia to re-invest in Ukraine. Instead, they tend to maximize the advantages of both areas, maintaining their plants in Slovakia and opening new factories in Ukraine.

Influence of the 'Italian model' on industrial policies in Eastern Europe

This dissertation research has shown that the 'Italian model' of industrial districts does have an impact on institutional change in Eastern Europe. Two different kinds of influence have been detected. At local level, communities of Italian entrepreneurs and managers have constituted associations which interface with the local institutions on matters of local industrial policies (especially in the case of Timisoara). More broadly, the neo-liberal policies that are prevalent among the new EU members lead to a welcoming attitude towards foreign investors, which reflects in the easy access to local mayors and public servants. Also, local elites played an important role in attracting Italian firms: in Timisoara, interpersonal networks in the industry played a major role in the establishment of the Italian firms, especially in the traditional sectors, where financial support from the local authorities is not available. In Kralovsky Chlmec (Slovakia) an entrepreneurial child doctor and former director of a socialist factory were successful in attracting Italian firms in their town.

At national level, the case study of Bulgaria (Chapter 5) has shown one of the ways in which the 'Italian model' is used as a blueprint for development policies; it also highlighted how the model is reinterpreted in the post socialist context. Chapter 5 has also highlighted the central role of consultants and international networks of institutions (the 'transnational institutional chains) as agents of post socialist change and EU-led institutional transformations. Through these networks the idea of clusters was introduced in Bulgaria; at the same time, the EU and other international donors – including USAID – are providing financial means for the implementation of cluster policies. However, the chapter has also highlighted that there is no connections between these nation level policies inspired by the Italian industrial districts and the activity of Italian firms.

New networks emerging as a consequence of Italian investments

In fifteen years of intensification of economic presence in Eastern Europe, Italian firms abroad are progressively building a national system of internationalization. Chapter 3 has shown that Italian banks and services, together with Italian chambers of commerce and firms associations abroad are at the heart of this system. The main characteristic of the system is a non binding set of relationship, based on language and cultural proximity. Italian banks and services abroad provide an interface with local norms, customs and financial institutions to Italian manufacturers. The presence of Italian speaking personnel, the understanding of both Italian and local norms, and the ability of reading Italian balance sheets are the reasons that lead Italian firms to turn to Italian services and banks. This constitute a 'weak system,' opposed to the 'strong system' adopted by German firms, in which banks in Germany provide support to firms start up in Eastern Europe and at the same time legally bind German firms to work with German banks. Instead, Italian firms move autonomously, and are not generally constrained by contracts to use Italian banks and services. This generates and uneven power relation, in which Italian firms constitute a small portion of banks' loans, and therefore are weak in negotiating the conditions of loans. At the same time, firms are free to turn to non-Italian banks and services. In this condition, Italian speaking services and cultural mediation are source of competitive advantage for Italian banks and services in attracting Italian firms.

Theoretical contributions

This dissertation explored new ways in which the analysis of the internationalization of Italian firms contributes to the literatures on Italian industrial districts, neo-regionalism and global value chains. It highlighted that the most recent studies on the Italian economy have shifted unit of analysis from the region (as it was the case in the literature on industrial districts) to the firm. It argued that that this new approach is weaker than the traditional Industrial Districts literature in addressing the role of local institutions and conventions, and the mechanisms of transmission of tacit knowledge in the overall performances of the districts. More in detail, it spoke to what Micheal Dunford (2006) called 'Marshall second argument,' i.e. that districts are not a purely economic phenomenon, but are centered on the interactions of economic and social systems. This dissertation explored the possibility to include these 'institutional dimensions' into the new firm-based approaches. It showed the ways in which Italian firms are inserting themselves into new communities throughout Eastern Europe, adapting to new social, cultural, political and institutional conditions. At the same time, by providing a sometimes relevant share of employment, and by engaging the local institutions in these communities they are an agent of post-Socialist change.

In so doing, this research contributed to the literatures on Italian industrial districts, neo-regionalism and global value chains in three ways. First, it analyzed the conditions of transmission of tacit knowledge. Within Italian firms abroad, the constant interactions of local managers, cadres and workers with Italian technicians/entrepreneurs/directors has both the function to transmit tacit knowledge through ‘learning by doing’ processes and to guarantee that the newly acquired notions are actually applied, without falling back in the old system once they leave. The Neo-regionalist literature considers untraded interdependencies based on social conventions developed through proximity at the root of the paths of technological development of regions. This dissertation argued that untraded interdependencies may also travel along the value chain, because the activity of contracting and investing often presupposes a thick set of face to face relations that favor the development of mutually understood codes. Second, it analyzed the processes of institutional transformation in Eastern Europe. Especially in the new members of the European Union, these changes are supported by grant schemes funded by the European Union and other international donors. Often these grant schemes involve joint projects between Western and Eastern European institutions. This dissertation argued that these projects lead to the establishment of transnational networks of institutions (‘transnational institutional chains’ described in Chapter 2 and 5) that have a structure similar to firms’ value chains. Specifically, they involve close co-operation between independent actors characterized by uneven power relations, and the transmission of specific knowledge along the chain, exactly as buyer-driven value chains do. Third, it argued that firms’ value chains and institutional chains lead to the establishment of ‘hybrid’ social spaces in Eastern Europe, in which both the EU-led transformation of local bureaucracies and the investors-led transformation of local textile and clothing and other firms are heavily influenced by transnational connections. Through their interactions, firms and institutions contribute to the diffusion of neo-liberal ideology in Eastern Europe.

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